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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 91/65

10:00 a.m., May 17, 1991

M. Camdessus, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
M. Al-Jasser	A. A. Al-Tuwaijri
	L. E. N. Fernando
C. S. Clark	
Dai Q.	
T. C. Dawson	
	V. Kural, Temporary
E. A. Evans	
	N. Kyriazidis
M. Finaish	A. F. Mohammed
M. Fogelholm	
B. Goos	
	T. Sirivedhin
	J. C. Jaramillo
	G. Bindley-Taylor, Temporary
J.-P. Landau	J.-F. Cirelli
	O. Kabbaj
	L. J. Mwananshiku
	P. Wright
G. A. Posthumus	G. P. J. Hogeweg
C. V. Santos	
A. Torres	R. Marino
A. Végh	
K. Yamazaki	

L. Van Houtven, Secretary and Counsellor
C. P. Clarke, Assistant

Also Present

El Sayed A. R. El Reedy, Ambassador of Egypt. IBRD: S. Voyadzis, Europe, Middle East and North Africa Regional Office. African Department: N. Abu-Zobaa, J. Artus. Central Banking Department: B. K. Short. Exchange and Trade Relations Department: J. T. Boorman, Director; M. A. El-Erian, G. R. Kincaid, E. van der Mensbrugghe. External Relations Department: R. R. Brauning, A. Mountford, H. Puentes. Fiscal Affairs Department: T. R. Muzondo. Legal Department: A. O. Liuksila, J. K. Oh. Middle Eastern Department: P. Chabrier, Deputy Director; H. Ghesquiere, M. D. Knight, A. T. MacArthur, M. G. O'Callaghan, A. Ouanes, C. A. Yandle. Research Department: B. E. Rourke. Secretary's Department: C. Brachet, Deputy Secretary; A. Tahari. Bureau of Statistics: J. B. McLenaghan, Director; M. Wasfy. Treasurer's Department: W. L. Coats, A. F. Moustapha. Western Hemisphere Department: P. J. Quirk. Personal Assistant to the Managing Director: B. P. A. Andrews. Advisors to Executive Directors: M. A. Ahmed, L. E. Breuer, M. B. Chatah, C. D. Cuong, B. R. Fuleihan, A. Gronn, J.-L. Menda, M. Nakagawa, A. Napky, Y. Patel. Assistants to Executive Directors: T. S. Allouba, A. Costa, T. P. Enger, N. A. Espenilla, Jr., S. K. Fayyad, M. A. Ghavam, M. A. Hammoudi, M. E. Hansen, M. E. F. Jones, P. Kapetanovic, J. Mafararikwa, R. Meron, C. Schioppa, J.-P. Schoder, N. Sulaiman, C. M. Towe, S. von Stenglin.

1. ARAB REPUBLIC OF EGYPT - 1991 ARTICLE IV CONSULTATION, AND STAND-BY ARRANGEMENT

The Executive Directors considered the staff report for the 1991 Article IV consultation with Egypt and a request by Egypt for an 18-month stand-by arrangement in an amount equivalent to SDR 278 million (EBS/91/73, 4/26/91; Sup. 1, 5/14/91; and Sup. 2, 5/16/91), together with a letter of intent (EBS/91/70, 4/22/91). They also had before them a statistical appendix (SM/91/95, 5/14/91).

His Excellency El Sayed Abdel Raouf El Reedy, Ambassador of the Arab Republic of Egypt to the United States, was also present.

The Chairman remarked that the present meeting offered a timely opportunity to report on his recent visit to Egypt, where he had had a long, extremely frank, and friendly discussion with President Mubarak. The President had been quite convincing in expressing his determination to see Egypt comply with the letter of intent. It was the President's conviction that only a dynamic private sector, together with a deeply reformed public sector, would enable the economy to grow at the rate required to create enough jobs for the population, which was increasing by 1.5 million people annually and would approach 70 million by the end of the century. The President had stressed that, if circumstances allowed, the Government would implement the program in a faster and deeper way than Egypt was committed to in the letter of intent. That objective was reflected in the President's most recent Labor Day speech, which had included a very clear and straightforward presentation of the program as well as a number of far-reaching commitments that went beyond those contained in the letter of intent. The President had noted that the current stance of reform allowed for only a low rate of growth after several years, and that the desired more rapid growth could be achieved only through deregulation, decontrol, and further privatization, and not through artificial budgetary or monetary stimulation.

After meeting with the President, the Chairman continued, he had held a lengthy discussion with the Prime Minister and the key members of the cabinet on the details of the program, during which the President's views on reform were confirmed. He had also met with the Speakers and other key members of the two Houses of Parliament, trade union leaders, important groups of leading economists, with whom he had discussed the more theoretical aspects of the program, key leaders of industry and the banking community, and the ambassadors of the donor countries, with whom he had discussed the financing of the program and the expectations of the donor community. In addition, there had been a number of opportunities for press and television contacts.

Mr. Finaish commented that he could only echo the Chairman's remarks; his authorities certainly viewed the program as a turning point for the Egyptian economy. He had left Egypt with the feeling that the authorities were committed to the course that they had charted, and the ongoing efforts of the President and his cabinet to explain to the public the need for policy change and its implications were indicative of that commitment. Obviously, short-term sacrifices would have to be made, and the authorities at different levels were aware of that, as had been pointed out to the Chairman on a number of occasions during his recent visit to Egypt. There were risks inherent in the type of reform that the Egyptian economy was undergoing. While the process would not be an easy one, his authorities were very hopeful that, with the support of the international community, the program would be a success. He wished to take the opportunity to thank the Chairman, on behalf of the Egyptian authorities, for the interest and support he had personally shown in reaching an agreement between Egypt and the Fund. He would also like to thank the staff for its hard and diligent work during the three and one half years of negotiations.

The Deputy Director of the Middle Eastern Department said that the staff had received additional information on policy implementation and recent economic trends. First, the World Bank had informed the staff that the legal drafting of a number of measures had been completed and had been reviewed by the World Bank staff, with issuance of the laws or decrees expected before the end of May 1991. Those measures included, in particular, the abolition of investment licensing requirements and controls on a number of activities as described on page 14 of the staff report, which had been due on May 10; ending of the requirement that letters of credit be opened for all imports; and reductions in the list of export bans, prior approvals, and annual export quotas, which had been due on May 15. Second, before May 15, teams of auditors had been appointed by the Central Bank to conduct the assessment of public sector banks. Third, the submission of the new public investment law to Parliament, which had been due by May 15, was still being finalized by the Central Bank. Similarly, the final increase in cotton prices for the current year--so that cotton prices would reach 60 percent of world equivalence--was still being discussed between the World Bank staff and a delegation from Egypt in Washington. Fourth, legislation to eliminate the taxation of treasury bills had passed the upper chamber of the legislature and would be discussed in the lower chamber on May 18. Fifth, while the program was fully funded in terms of financing assurances, an issue had been raised about medium-term viability. It was the staff's understanding that, on the basis of the scenarios in the staff report, the various solutions currently under discussion by creditors would yield viability. Finally, the latest information indicated that the acceleration in price increases noted in the staff report had continued. The 12-month rate of increase had reached 17 percent in April, and the increase in the first four months of the year was close to 30 percent at an annualized rate. In the staff's view, that trend underlined the importance of the authorities acting forcefully on credit and monetary policy, particularly as substantial administered increases in prices had taken place owing to the introduction of the sales tax, the energy price increase, and a higher tariff rate.

Mr. Finaish made the following statement:

As Directors are aware, the medium-term adjustment and reform program, in support of which Egypt is requesting a stand-by arrangement with the Fund and a structural adjustment loan from the World Bank, is the culmination of a lengthy process of discussions and consultations between the Egyptian authorities and the two institutions. In the course of that process, the authorities have moved on many policy fronts and have implemented important measures in the fiscal, monetary, exchange rate, and pricing areas. Steady efforts have also been made to garner the requisite public support for the type of structural economic reorientation that the authorities are aiming for. This period of preparation has not only facilitated the agreement with the Fund and the Bank on the medium-term program before us today, but has also meant that by the time the arrangement is approved, most key policy measures will already be in place.

The program before us should leave no doubt that what the authorities are aiming for is nothing less than a fundamental transformation of the economic system. The objective is to create a decentralized, market-based economy, in which a growing private sector and a restructured and scaled-down public sector compete on an equal footing in a stable macroeconomic environment. Controls on economic activity and investment are being dismantled, and primary reliance is being placed on market forces for pricing and resource allocation.

Egypt's comprehensive and fully articulated structural reform plan and the strong macroeconomic adjustment that underpins it are of a type usually supported by multiyear facilities, such as the extended Fund facility and the enhanced structural adjustment facility (ESAF). The stand-by arrangement being requested should therefore be considered as a transitional arrangement toward another arrangement that would be commensurate with Egypt's medium-term program.

Now that Egypt has regained eligibility for International Development Association (IDA) lending, consideration should also be given to making Egypt eligible for ESAF resources. The forthcoming review of the ESAF provides a good opportunity to consider broadening the list of eligible members to include countries like Egypt, whose per capita income and balance of payments needs are in line with the eligibility criteria.

While recognizing the broad coverage of Egypt's reform program, the staff seems to argue for an accelerated pace of implementation. But this should not detract from the strength of the program. As we all know, the design and phasing of comprehensive structural reform programs are complex matters, as they need to take into account interlinkages and feedbacks among various policies and sectors, as well as implementation capacity. Beyond this, an important requirement for the sustainability and success of structural reform is the ability to achieve macroeconomic stabilization relatively quickly. This often requires fiscal and monetary tightening in the initial phase in order to prevent price adjustments from building an inflationary process into the system. If the initial price adjustment is not accommodated, then the faster the pace of structural reform, the greater the short-term output and real income losses. Alternatively, if monetary and credit policies are relaxed in order to avoid the additional loss in output and decline in living standards, the risk of an inflationary upsurge would be greater. Therefore, in charting the pace of structural reform, one has to keep the short-term output and inflation implications very much in mind.

In the case of Egypt, a sharp fiscal and monetary tightening is expected to help in containing the jump in prices projected for 1991/92, which is associated with the administered pricing and decontrol measures that are being implemented under the program. This tightening will inevitably have an adverse effect on the real economy, as reflected in the 3 percent decline in real GDP projected for this coming year. With the high rate of population growth and the return of hundreds of thousands of workers from other countries in the Middle East, this implies a significant decline in real per capita income. We tend to think in relative terms, but absolute magnitudes are also important. For example, the same percentage decline in living standards in a country where per capita income is $600 or $650 would have different implications for the average household than it would in countries where per capita income is $2,000 or $2,500. It is true that Egypt's program includes the setting up of a social fund, which is expected to address some of the social difficulties, particularly those associated with the returning workers from abroad, but it could hardly be expected to alleviate the enormous hardships that could result from an even sharper decline in living standards than is currently programmed, even if such a decline were temporary.

On the other hand, the risks to macroeconomic stability that could result from an even sharper increase in the price level in the initial period could also be very high. This is especially so given that the exchange rate and interest rate systems have just been liberalized and a cautious wage policy is a critical element in the stabilization process. Under the program, prices are already expected to rise by more than 30 percent. An even larger price increase, which would likely result from a further front-loading of structural measures, would increase the risk of a price-exchange rate-wage spiral, and thus endanger not only the macroeconomic program but, the structural reform as well.

Having said this, it is important not to be left with the impression that Egypt's structural reform program is not a strong one, or that the authorities would not consider advancing the implementation of certain measures if circumstances proved favorable, particularly in relation to inflation and the other macroeconomic targets.

It is not necessary for me to describe in any detail the specific elements of Egypt's economic program. The documents before us do that very well. But one feature of the program that should be emphasized is that the policies that will bring about macroeconomic stabilization are, by and large, also structural in nature and should lead to a lasting improvement in the working of the Egyptian economy. This is true for fiscal, monetary, as well as exchange rate measures.

For example, the policies that will bring about a sharp reduction in the fiscal deficit, from 15 percent of GDP--excluding bank recapitalization costs--in 1990/91 to about 10 percent of GDP in 1991/92 and 6.5 percent of GDP in 1992/93, will also strengthen the elasticity of the revenue structure. The general sales tax and the planned personal income tax are prime examples.

Also, in the monetary area, the authorities have not only tightened credit expansion significantly in line with the stabilization objective, but have also initiated fundamental reforms in the interest rate and credit allocation systems. These measures, along with the steps taken to strengthen the banking sector, should contribute significantly to investment efficiency and to an output recovery led by the private sector.

Similarly, the fundamental reform of the exchange rate system will be instrumental in removing price distortions and in bolstering confidence in the domestic currency. This should not only help in reversing the dollarization of the economy that has taken place over the past decade, but also enhance capital inflows, including those from Egyptians living abroad.

These are fundamental reforms in critical areas of the economy, and it is crucial that they be sustained. It is true that, in some respects, the functioning of treasury bill auctions and the exchange market need to be strengthened. Indeed, given the systemic nature of reform in these two areas, some sensing of the way in the initial period, on the part of both the authorities and the market participants, is inevitable. The authorities are working closely with the Fund staff to ensure that all impediments to a full interplay of market forces are removed quickly: Toward that end, legislation to rescind taxes retroactively on treasury bill earnings has been submitted to Parliament, and public sector banks with excess liquidity are being excluded from competitive bidding pending the reduction in their liquidity ratio. Moreover,

the authorities are moving as rapidly as possible to license foreign exchange dealers to complement the 40 banks and the Port Said dealers that already engage in foreign exchange transactions. So far, 64 dealers have been issued licenses and 10 dealers have already been incorporated.

Turning to the medium-term outlook for the balance of payments, I would make three observations. First, the staff projections illustrate clearly the fragility of Egypt's external position and the extremely heavy burden that external debt will continue to place on the balance of payments over the medium term. The debt cancellations that a number of creditors have provided will certainly have an ameliorating impact on the debt-servicing burden. Moreover, the assistance that has been provided by the Gulf Crisis Financing Coordination Group (GCFCG) has also strengthened Egypt's external position in the short term. But it is equally clear that for medium-term viability to be achieved, a further substantial and permanent reduction in the external debt burden is needed. Second, the rate of economic growth in the medium term, which is close to the rate of population growth, is hardly satisfactory. An important determinant of output growth in the medium term will be the extent to which private investors, domestic and foreign, respond to the structural reforms. This in turn is influenced by expectations and perceptions about the viability of Egypt's external position. Third, the balance of payments projections presented in the baseline scenario are based on favorable assumptions about the external environment. The alternative scenario presented in Table 8 of the staff report demonstrates the kind of balance of payments gaps that could emerge if the external environment turned out to be less favorable.

All this points to the need for Egypt's adjustment effort to be supported by a substantial and lasting reduction in its external debt burden, in addition to the official flows already assumed in the projections. The positive indications from the Paris Club creditors are, therefore, most welcome.

The risk of an unfavorable external environment is not just a medium-term concern. The authorities recognize this and are prepared to take additional pre-specified fiscal measures as needed. Although an explicit contingency mechanism is not incorporated in the arrangement for the reasons mentioned by the staff, if the need arises, an increase in the amount of financing provided by the Fund could also play a useful role. The low level of access under the arrangement could justify such an augmentation, which would be very much within the Fund's existing policies and guidelines. Having said this, the hope is that the external environment and Egypt's relatively favorable short-term cash flow position would obviate the need for contingency action.

To conclude, Egypt has embarked on a comprehensive and fully articulated plan of reform, supported by a strong stabilization program. The authorities are committed to the course they have charted and deserve the full support of the Fund and the international community.

Mr. Al-Jasser made the following statement:

At the outset, I would like to welcome the conclusion of the lengthy discussions leading to the preparation of this program with Egypt. Commendation should go to the Egyptian authorities for not losing faith in the desirability of adjustment. This is a testimony to their belief that Egypt deserves a better-functioning and, hence, more self-reliant economy than hitherto has been the case. The Chairman and the staff should also be commended. I am sure that the efforts expended in designing the program before us today are worthwhile and will prove to be a good supporting basis for its successful implementation. The Chairman's comments this morning on his visit to Egypt are indeed heartening and reassuring with respect to the determination of the Egyptian authorities to proceed vigorously with adjustment in order to realize the positive prospects of the Egyptian economy.

The program before us is strong, ambitious, and comprehensive. Any doubt about this fact could be easily dispelled by looking at Table 5 of the staff report. Excluding the additional expenditures owing to restructuring, the fiscal effort to the end of the present calendar year will amount to about 18.7 percent of GDP. It should be noted that most of this effort is in the form of prior actions on the revenue side of the balance sheet. The fiscal effort envisaged for fiscal year 1992/93 is also impressive, although not yet quantified.

The list of structural reforms in Appendix IV of the staff report, the far-reaching private sector investment policy, the exchange system reform, as well as the monetary reform highlighted in Appendices V, VI, and VII, respectively, cannot be called anything but comprehensive. Hence, I agree with Mr. Finaish that this program aims at a fundamental transformation of the economic system through a critical mass of reform that is being implemented at an ambitious pace.

Therefore, my main conclusion is exactly that of the staff: the program is likely to tax the implementation capacity of the authorities. However, this should not be a cause for despair or complacency but, rather, should be a call for an exemplary effort of collaboration between the Fund, the World Bank, and the Egyptian authorities to ensure that this ambitious program is implemented successfully. This is critical if economic growth is to be resuscitated after three lean years of negative real growth.

After all, this is a relatively poor country, with more than 50 million people and a GDP of only $28 billion. In this regard, I welcome the creation of the social safety net, which should contribute to ameliorating the hardship incurred by the most vulnerable segment of Egyptian society.

In addition to these general remarks, I have a few specific comments. On fiscal policy, I believe that the Egyptian authorities have just made a substantial down payment on fiscal consolidation. The record of excessively expansionary fiscal policies appears to have been brought under control with this program, particularly through the revenue-enhancement measures that have been, or will be, implemented. Most significantly, the budget for 1991/92 is projected to register a primary surplus for the first time in years. However, the challenge remains that of improving tax administration, so as to bring about the realization of the system's revenue potential. Another challenge in this area is to initiate an expenditure rationalization process, whereby more prominence is given to expenditures that enhance the investment and productivity potential of the economy in the medium and long run. I am glad to note that the staff has alluded to the importance of increasing expenditures on operations and maintenance. It is my hope that the ratio of investment spending will also not decline but, rather, rise over time.

On monetary policy, the shift to instruments of indirect monetary control and the introduction of the treasury bill auctions should enhance the transparency of financial market transactions and allow the authorities to influence financial markets in a prudent and predictable way. Moreover, the reduction of excessive government borrowing and an effective solution of the liquidity overhang should create a virtuous circle of containing inflation and remonetizing the economy. A corollary of such developments will be the attainment of positive, and eventually declining, real interest rates, as well as a crowding-in of private borrowing-cum-investment. Furthermore, the restructuring of some commercial banks in the context of a broader reform of the financial system should invigorate the process of financial intermediation. The financial sector of the economy should be able to support the real sector in efficiently allocating the scarce resources of the economy if economic growth is to be regained and high unemployment is to be reduced.

On the external accounts, I believe that the authorities have made the right decision in simplifying the exchange rate system by reducing it to two tiers, with the wedge not to exceed 5 percent. This should make the unification of the system in February 1992 a mere formality. However, what is significant is that this is happening at a time when foreign trade is being liberalized at a pace such that, according to the staff, "by mid-1993, foreign trade will be almost free of nontariff barriers, virtually all

cropping and price controls and input subsidies in agriculture will have been eliminated, and 90 percent of manufactured production will be sold at freely determined market prices." I wish we could say the same about most of the membership, especially those members with a greater impact on the world economy.

Egypt's external position is determined predominantly by workers' remittances, oil exports, and revenues from tourism. However, Egypt is a populous country with a great potential for other exports. While noting the assumption in the program of a 10 percent real increase in non-oil exports, I believe this should have received greater attention in the staff report, especially with regard to the diversification of exports. In addition, attracting foreign investment, particularly in the export sector, should be emphasized by complementing the ambitious law on private investment with the elimination of bureaucratic barriers to foreign investment.

In addition, I agree with the staff that the authorities need to follow prudent external borrowing policies, lest the debt-servicing problems of the recent past recur. In this regard, the debt relief awarded to Egypt by the United States and the Gulf Cooperation Council (GCC) members, as well as that anticipated from the Paris Club, should augur well for the future. It is my hope that the Paris Club will send positive signals about Egypt's future debt profile.

On the energy policy, the recent measures taken by the authorities, combined with the decline in international oil prices, should bring domestic prices to, or even higher than, the agreed ratio of international equivalence. However, the efficiency of the utilization of energy sources should be the main concern. Given that domestic gasoline prices in Egypt are higher than international levels, could the staff indicate why Egypt consumes such a large amount of fuel oil, which appears to be the culprit in this issue?

In conclusion, I would like to urge all involved to do all they can to ensure the successful implementation of this ambitious program. The Fund can, through technical assistance and follow-up, help in this endeavor. At this juncture, it is well worth noting that the success of this program has positive spillover effects in the region that should not be underestimated. It is my hope that Egypt will be able to crown the success of this program with a follow-up arrangement that enjoys a more commensurate level of access than has been necessary for this stand-by arrangement.

With these remarks, I support the proposed decisions.

Mr. Dawson made the following statement:

We are very pleased that Egypt and the Fund have at last reached agreement on an economic program that can be supported with Fund resources. In our view, this agreement is significant in several respects.

First, it marks a serious effort on the part of the Government to address Egypt's economic problems in a comprehensive way. Mr. Finaish has aptly described this effort as "...nothing less than a fundamental transformation of the economic system." Second, the agreement comes at a very propitious moment, when the support of the international community for Egypt's adjustment efforts is exceptionally strong, providing an exceptional opportunity for Egypt to carry out a comprehensive adjustment program. Indeed, the external assistance mobilized for Egypt through the GCFCG has provided a critical boost to the authorities' confidence in their ability to undertake a far-reaching program of this kind. Finally, the agreement is the result of extraordinary efforts on the part of Egypt and the Fund, and I would like to commend the Egyptian authorities, the staff, and management for their perseverance throughout a particularly difficult series of negotiations.

Reaching an agreement with the Fund is a considerable achievement in and of itself, but it is only the first step in a long process of economic reform. It is therefore essential that Egypt seize this opportunity to make substantial and lasting improvements in the structure and functioning of its economy.

The central objective of Egypt's reform effort should be to establish the conditions necessary for a dynamic private sector that is capable of sustaining high levels of noninflationary growth and employment generation. This, in turn, will require strict adherence to fiscal and monetary stabilization policies to reduce the size of the budget and current account deficits and bring down inflation. At the same time, market-determined price signals must be allowed to guide resource allocation, and the economy as a whole must be opened to domestic and foreign competition.

The authorities have made some substantial progress in this direction through their prior actions, but their efforts cannot stop there. On the fiscal side, important deficit-reducing measures have recently been taken and other measures are planned for later this calendar year, and by 1992 they should result in a very large reduction in the deficit as a share of GDP. Yet, as ambitious as the fiscal program is, at 6.5 percent of GDP, the size of the budget deficit as a share of GDP will still be quite

large in 1992/93, indicating the need for continued adjustment beyond the program period.

The principal effort so far has been on raising revenues, which is certainly necessary and probably unavoidable in the short run. However, in the future, much more emphasis will need to be placed on cutting expenditures as well. The civil service reform to be undertaken with World Bank assistance, further cuts in subsidies, and better targeting of remaining subsidies could provide substantial budgetary savings. I would also add that the program's trade liberalization goal will require less reliance on high customs duties as a major source of revenue.

A tight credit program is essential to contain inflationary pressures, and within this program, it will be important to contain credit expansion to the public sector so as to leave as much room as possible for credit to the private sector. At the same time, the authorities need to establish the appropriate monetary conditions so that interest rates will be positive in real terms and perform their intended role in resource allocation. The establishment of a treasury bill market is a very positive step, but the authorities need to work with the Fund staff to ensure that it operates properly. Likewise, a market-determined exchange rate is critical to improve domestic price signals and current account performance. Hence, we also attach great importance to a freely functioning secondary exchange market and look forward to the unification of the exchange system by February 1992, as agreed.

It should be clear that this program is, in many senses, an ambitious one. It calls for large reductions in Egypt's fiscal and current account deficits, as well as significant price adjustments and institutional changes. Nevertheless, some important aspects of the necessary structural change, such as privatization of state enterprises and full price and trade liberalization, will occur only over a number of years. While there are understandable reasons why the Egyptian authorities have opted for this slower pace of structural reform, it must be recognized that there is some additional risk attached to this approach.

The success of the strategy depends upon the private sector providing new impetus for growth and employment, but without rapid structural change, the private sector may be slow to take up the slack in the economy. In short, Egypt may see a longer period of contraction before the benefits of adjustment are felt, possibly undermining domestic support for the program. In this context, it is troubling that per capita GDP growth is projected to become positive only in 1995/96. Thus, we would urge the authorities to bear the risk of gradualism in mind and to look for ways to accelerate the pace of adjustment where possible. In any event,

the authorities must avoid any delays in the timetable agreed with the Fund. The authorities should also expedite the establishment of the Social Fund in order to mitigate the hardships faced by vulnerable segments of society as the adjustment program proceeds.

Although we are very encouraged that Egypt has reached this agreement with the Fund, it is still abundantly clear that, in addition to Egypt's own adjustment efforts, large amounts of external assistance, including debt reduction, will be needed to close future financing gaps. The United States has already canceled almost $7 billion in bilateral debt, and we hope other creditors will also come forward with comparable relief.

In conclusion, we support Egypt's stand-by request. The program it supports maps out a difficult but, we believe, feasible adjustment path for Egypt to follow. We hope that with the continued diligence of the authorities and the Fund staff, we will be in a position to consider a longer-term arrangement for Egypt in due course.

Mr. Landau made the following statement:

My authorities warmly welcome the conclusion of an agreement between Egypt and the Fund. They are convinced that such an agreement is indispensable to help Egypt solve its difficulties and renew its growth. As we all know, the negotiations have been a long and difficult process, but we believe that this long maturing period has proved fruitful, judging by the comprehensiveness of the program before us. Comprehensiveness appears, indeed, to be the main characteristic of this program, since it encompasses all the areas of structural reforms as well as a strict macroeconomic framework.

I will deal successively with the package of structural reforms, the adjustment measures, and, finally, the external prospects and the debt problem.

In one sense, the program before us has avoided the question of sequencing by addressing most issues in a simultaneous way, with the exception of privatization, which, for the most part, will follow a period of what we could call "corporatization" of public enterprises.

The first group of reforms, consisting of price liberalization and exchange and trade reforms, will be essential in order to reduce price distortions and restore a structure of relative prices more in line with international markets. Price distortions have had a damaging effect in Egypt, especially for those products for which Egypt is both a producer and a consumer and in which it enjoys a comparative advantage. Such is the case, for instance,

with energy prices, which explains why consumption of petroleum products has grown by 7 percent a year during the last decade and net oil exports fell to 36 percent of production. Price distortions also encouraged the maintenance of inefficient energy-intensive industries with adverse consequences for the environment. It is also time that the low procurement prices for cotton, which have resulted in a continuing reduction in production to the benefit of other products in which Egypt has no comparative advantage, are raised. Therefore, we warmly welcome the envisaged measures agreed by the authorities with the Fund and the World Bank.

Exchange and trade liberalization will be an indispensable complement to price liberalization and will allow for an adequate structure of international prices to be fully reflected in the internal market. Therefore, we welcome the reform of the exchange system, whose first steps have already been implemented. The introduction of a dual system, led by the rate cleared on the free market, and the prospect for unification in less than one year is certainly an important move for the Egyptian authorities. It is, of course, important that the authorities ensure a proper functioning of the market by accelerating the licensing of the nonbank dealers.

The progressive elimination of quantitative restrictions will also be essential in the process of redeployment of resources in Egypt.

All these measures should have a positive impact on the supply side of the economy. The envisaged measures of investment decontrol are therefore indispensable to ensure a rapid positive response of the private sector. In this respect, perhaps the adoption of a unified investment law, envisaged for only end-1993, could be brought forward to an earlier date. I would welcome any comment by the staff in this regard.

The second important element of the structural reform package is the reform of public enterprises. The authorities have opted for a first step in which public enterprises are given more autonomy and accountability in an environment similar to that of the private sector. The creation of holding companies, fully responsible for the profitability of their affiliates, should contribute to the success of this first step in view of the future privatization plan. We fully endorse the authorities' intentions in this area, including the plans to sell over 2,000 small economic units owned by local governments. The initial phase should be accompanied by an intense restructuring of these enterprises, including the closing down of loss-making ones. I also share the staff's view that cross-subsidization within the different groups should be avoided to the extent possible.

The whole package of reforms will be implemented in a gradualist manner in the period up to 1995/96. The staff clearly points to the risks involved with too slow a pace in the implementation of the reforms. Nevertheless, my authorities believe that the special circumstances that prevail in Egypt and the risks of social disruptions justify such an approach. One can hope, furthermore, that if a clear timetable of reform is established and agreed upon with economic agents, it would create a favorable climate for investment and growth. In such a context, the authorities should be careful to implement all the measures as scheduled and accelerate some of them, circumstances permitting, in order to consolidate the return of confidence. A timely and complete implementation of the program should send the right signal to economic agents and influence expectations.

Let me now turn to the adjustment program.

We welcome the significant measures of adjustment taken by the authorities, since an appropriate macroeconomic framework will be necessary to the whole process aimed at releasing resources to the private sector and reviving growth.

Fiscal policy will play a crucial role in this process, and, clearly, the measures adopted so far, amounting to 7.5 percent of GDP on a 12-month basis, are ambitious. We are also quite encouraged by the very detailed schedule of measures agreed upon, which should aim at reducing the public sector deficit to 10.3 percent of GDP in 1991/92 and 6.5 percent of GDP in 1994/95. The introduction of the General Sales Tax is certainly an important measure. Its extension and conversion into a value-added tax will be especially critical to the success of the program. Furthermore, the adjustment of public prices, and energy prices in particular, will play a significant role in enhancing revenues. On the expenditure side, the progressive reduction of subsidies as well as the limitation of salary outlays will play a significant role in limiting the deficit. The authorities' commitment to limit the increase in the wage bill to 16.4 percent in 1991/92 is also a very positive sign.

Monetary and credit policies will be essential in order to avoid the substantial price increases and ensure that the presence of a monetary overhang does not initiate an inflationary process. Furthermore, the policy of low and negative real interest rates pursued so far by the authorities has led to an increasing dollarization of the economy.

Therefore, we consider the adoption of the monetary reform as essential. The introduction of weekly auctions of treasury bills and the elimination of interest rate ceilings are important steps in the introduction of a more flexible, market-oriented monetary policy. As could be expected, the initial operations of the

system have proved somewhat hesitant, and prompt corrective measures have been adopted to ensure a smooth functioning of the market. In the meantime, it is essential that traditional credit controls be maintained in order to strictly control credit expansion.

Lastly, I will turn to the external prospects and the debt issue.

The staff report makes a very clear and convincing case for the necessity of debt reduction so that Egypt can return to external viability. In the very short run, substantial grants and loans have largely offset the impact of the Middle East crisis, resulting in an overall payments surplus of $0.9 billion in 1990/91. The staff projects that the balance of payments will return to deficit as soon as next year, with exceptional financing needs of about $1.7 billion annually in the years ahead. I wonder whether these assumptions are too pessimistic and whether they take into account all the contributions committed to Egypt during the Middle East crisis. I would welcome any staff comment on this point. Nevertheless, levels of interest payments equivalent to 9 percent of GDP are a clear indicator of the extent of the debt overhang. Therefore, we believe that substantial debt reduction is needed in order to ensure the confidence in the process of reform and adjustment.

Next week, the Paris Club will meet on this issue, and France will support a debt reduction equivalent in net present value terms to 50 percent of the stock of debt. We are also willing to consider possible debt-conversion operations. Precise modalities will be defined next week and will carefully take into account the Fund's balance of payments projections. As mentioned in the staff report, the international reserves targets will need to be adjusted according to the precise modalities of the agreement.

We also hope that other creditors will grant comparable terms to Egypt, since we are particularly attached to an equitable burden sharing. On this issue, we believe that the assumptions incorporated in the staff report--rescheduling of 100 percent of the principal and new money--do not totally meet this objective of comparability of treatment.

In conclusion, let me say that my authorities wish the Egyptian authorities every success in the ambitious program of reform on which they have embarked.

Mr. Fogelholm made the following statement:

I join my colleagues in welcoming the agreement between Egypt and the Fund, which indeed took an extraordinarily long time to conclude. My authorities believe that this program will provide the basis for a considerable strengthening of Egypt's economy, but, as a minimum, this will require that the previous problem of slack policy implementation does not resurface. Thus, I am pleased to note that the prior actions, which were to be completed by mid-May, have been executed broadly according to plan. I am also encouraged by the Chairman's opening remarks as regards the pronounced commitments to reform, and possibly even to accelerated reform, by the authorities.

However, looking at the program before us, this chair is nonetheless concerned about its relatively slow timetable. Although the Egyptian authorities have, indeed, moved on many policy fronts, and although a number of prior actions have been implemented, the economic program still consists, to a large extent, of intentions and plans for future action. Therefore, and in light of Egypt's unsatisfactory track record of program implementation and the exceptionally favorable short-term financing situation, the program should preferably have been more front-loaded, as more rapid implementation of the reforms would provide a better safeguard against problems that may arise from the impact of unfavorable external developments. We also endorse the staff's view that the gradualist approach implies large costs, and we cannot really accept Mr. Finaish's arguments against a more rapid adjustment. Experience gained from other countries would not seem to support his view. More ambitious fiscal retrenchment, combined with a strict monetary policy and measures to abolish structural rigidities in the economy, should fairly quickly counteract the initial price shock of the faster liberalization of prices and cuts in subsidies. Efficient use of the established Social Fund could--to our mind--have facilitated faster policy implementation without incurring the feared social consequences.

I am also somewhat doubtful about the realism of the current timetable for some of the reforms in the pipeline. For instance, the Government is planning a series of reforms in the area of personal and corporate income taxation. But as we all know, such reforms may--even in a developed economy--easily take years to prepare and implement. With the timetable set for these reforms--namely, mid-1992--one can question whether they can be introduced on time, as the preparatory work has barely begun.

Achieving macroeconomic stability is going to be crucial to the success of the reform program; consequently, it is imperative that the current liquidity overhang in the economy be rapidly eliminated. For this reason, the authorities should strictly adhere to the plans to reduce the public sector deficit.

Initially, this will be attained mainly by increasing revenues. However, it will become necessary as soon as possible to place greater emphasis on expenditure reduction, not the least to cut subsidies.

In general, the role of the public sector should be lessened. In this context, the privatization program is crucial, and my authorities are concerned about the expected slow pace of this process and the manner in which the authorities plan to execute it--specifically, the intention to employ holding companies. Like the staff, I am doubtful about the efficacy of this approach.

Another cornerstone of the reform process is the efficient allocation of resources. To that end, a realistic price structure must be quickly established, which, inter alia, requires that interest rates be market based. In this connection, it is disquieting that positive real rates will not be achieved until fiscal year 1992/93. It is equally disturbing that decontrol of the domestic pricing system is not expected to be complete until mid-1995.

Specifically on the energy price adjustment, which this chair also considers to be too slow, we would be interested to learn how this agreement was arrived at, in light of the different views on this issue at the Fund and the World Bank earlier on.

As regards exchange rate policy, aside from the importance of observing the performance criterion to abolish the multiple currency practices, it is essential that the authorities adhere to a policy that will enable Egypt to service its external debt. Moreover, the Government will need to abstain from any kind of intervention in the money and currency markets so as not to distort their proper functioning. Here, I refer to the emergence of parallel exchange markets even after the reform of the foreign exchange system in late February of this year. This would seem to indicate that the Egyptian authorities have not fully lived up to their intentions in this area.

Another worrying feature, on which I would appreciate the staff's comments, is the fact that the real economy seems to react only modestly to the more flexible exchange rate policy, which I assume will be the result of the unification of exchange rates. The staff's base scenario provides us with projections suggesting that the current account will be improving over the decade. However, this is due to an expected strengthening of the services balance and an increase in workers' remittances, both of which are uncertain, even though plausible, outcomes. The trade balance, however, which more fundamentally reflects the developments in the real economy, is expected to continually deteriorate in absolute terms. I am somewhat surprised that the combination of the revised foreign exchange rate policy and structural reforms is not

expected to produce an improved trade balance over a period of 10 years. Nevertheless, if that is the case, questions can be asked about whether a program failing to bring about such a basic improvement over the medium, or even long, term will gain the confidence of the outside world.

It is clear that only a credible economic program and its strict implementation will make it possible for Egypt to cover the remaining relatively large financing gap. Credibility is particularly important for Egypt's ability to attract financing over the medium term, considering that the negotiations have only just begun.

In this connection, and here I refer to the staff appraisal--first paragraph on page 48 of the staff report--my authorities would be interested to know what is meant by "continuous or permanent exceptional assistance." It would seem that the prospect of securing exceptional support on a continuing or permanent basis appears limited. Furthermore--in reading the end of that same sentence, which says that the assistance should take a form that does not "exacerbate these gaps"--are we to understand that the external situation is such that the staff is proposing that Egypt be extended only concessional financing or be granted debt relief? A final question on this issue: with reference to page 8 of the staff report, we would be interested to know which "other donors" than the Paris Club the Fund management intends to approach in order to get assurances of debt relief and aid.

As the need for close monitoring of the program's progress is obvious, we are pleased to see this aspect emphasized. We, of course, share the staff's view that if at any time the program risks going off track, sufficiently strong corrective policy measures must be taken immediately in order to maintain confidence in the program.

To conclude, this program is an important beginning to balanced economic development in Egypt; however, the pace of reform is clearly a cause for concern and should, if at all possible, be accelerated, for instance, in connection with upcoming program reviews. In light of the many important prior actions already undertaken, this chair is willing to give the Egyptian authorities the benefit of the doubt and accept the stand-by arrangement before us. Nonetheless, we would like to stress that the Fund's support for the program should be reconsidered if deviations emerge from this relatively weak program. It is also much too early to start talking about an augmentation of the program.

Mr. Kabbaj made the following statement:

We welcome this Article IV consultation with the Arab Republic of Egypt and commend the authorities for their steadfastness and perseverance in launching a solid and credible medium-term program to be supported by the Fund through a stand-by arrangement. As indicated in the comprehensive staff report and Mr. Finaish's interesting statement, the long time taken to reach such an agreement is due to the complexity of the situation and the necessity to garner the necessary public support for this important undertaking.

Indeed, economic growth has slowed markedly during recent years and has even become negative, and inflation has accelerated to unsustainable levels. The budget deficit remained at about 20 percent of GDP, while the external current account deficit--excluding official transfers--hovered around 12 percent of GDP. The reasons for this worrisome situation are well known. Despite continuous efforts at economic reform, the economy of Egypt has been suffering from decades of state controls, distortions, inadequate exchange and interest rate policies, and expansionary financial policies. Moreover, the measures taken to correct these large imbalances were not conceived in a comprehensive framework and were too gradual.

Another important element that contributed to the deterioration of the economy is the high and unbearable level of the external debt--despite the modest debt relief provided to Egypt in 1987. This level is one of the highest in the world, with ratios of outstanding debt to GDP of 120 percent and interest payments to GDP of 9 percent. In this regard, we note that recent initiatives by creditors to reduce this debt burden have contributed to encouraging Egypt to embark on the ambitious program we are considering today.

We agree with the objectives of the program and find them appropriate. It is indeed vital that the Egyptian economy be transformed into a "decentralized market-based, outward-oriented economy," to use the words of the staff report, and one in which a revitalized private sector is encouraged by a stable and competitive environment. We believe that the courageous financial measures taken so far and the ambitious program of structural reforms are steps in the right direction.

It would probably have been preferable to have a speedier pace of implementation of these reforms, but we tend to agree with the authorities that account should be taken of social and political constraints if we are to avoid a repetition of past rejections of the adjustment process. We are encouraged in this regard by the commitment of the authorities to keep the pace of implementation under review in the light of circumstances, and we

hope that this possibility will be realized if circumstances warrant, especially where encouragements to the private sector are concerned.

Similarly, we are surprised by the modest rates of economic recovery projected in the program. After all, the program is both bold and comprehensive, and one would expect in such cases a speedier response. Is the debt forgiveness expected from Paris Club creditors likely to sizably change the outcome? If not, we would be concerned that the support for the painful adjustment measures could wane before Egypt is on more solid ground. This is especially true, because, as recognized by the staff and the authorities, the program entails a high social cost, at least in its first phase. We note the actions taken in the framework of the program to address these issues, but have the feeling that the amounts envisaged under the social fund and extrabudgetary investment are not commensurate with the magnitude of the problem.

This being said, we encourage the authorities to persevere with the implementation of the program, for this is a unique opportunity for Egypt to rebuild its economy. However, like Mr. Finaish, we feel that this comprehensive medium-term program would have qualified for support in the form of an extended arrangement or an enhanced structural adjustment arrangement, and, hence, the present stand-by arrangement should be considered as a bridge toward a more appropriate form of support. In this regard, we wish to support Mr. Finaish's suggestion that Egypt be added to the list of ESAF-eligible countries, and we agree that this eligibility is justified by both the per capita income and the balance of payments need of Egypt.

Finally, we believe that the program before us deserves the full support of the Fund, the World Bank, and the rest of the financial community. We hope that the forthcoming meeting of the Paris Club will recognize the difficult situation of Egypt and its big efforts at adjusting by granting generous terms for the necessary debt relief. In this regard, we fully support the staff's and Mr. Finaish's suggestion that this relief take the form of a substantial and lasting reduction in the heavy debt burden.

In closing, we support the proposed decisions.

Mr. Clark made the following statement:

Like other speakers, we welcome the Egyptian authorities' commitment to a fundamental restructuring of their economy and their desire to do so in the context of a Fund stand-by arrangement. The prior actions that the authorities have taken provide encouraging reassurance of this commitment to reform, as

do the Chairman's comments and those of Mr. Finaish this morning. Nonetheless, after reading the staff report, and particularly the staff appraisal, we cannot help but express some concerns regarding the adequacy of the program.

There is no doubt that the ambitiousness of the programmed fiscal and monetary adjustments would raise concerns regarding their attainability in any Fund program. However, in my view, these risks are magnified considerably as a result of the authorities' willingness to adopt only a relaxed pace of structural reform. Unlike Mr. Finaish, I feel that, given the price and other distortions under which the Egyptian economy now labors, this gradual approach places the program's macroeconomic and structural adjustment objectives at some risk. In particular, one has to be concerned that the decline in output projected for this fiscal year, as well as that experienced in 1990/91, has been exacerbated by this gradual approach to reform. I would, therefore, strongly encourage the authorities to use every opportunity to accelerate, rather than delay, the reform process.

Let me now comment briefly on some of the specifics of the program.

As I have already mentioned, the program's fiscal objectives are ambitious. Nonetheless, if the authorities are successful in reducing the fiscal deficit by 14 percentage points of GDP over two years, as well as introducing the planned structural revenue and expenditure measures, they will have laid the groundwork for a durable solution to their fiscal problems. However, we cannot help but be concerned regarding the authorities' ability to meet these difficult objectives.

More specifically, we have some doubts regarding the anticipated yield of the General Sales Tax (GST). The expectation of gross receipts of 3 percent of GDP seems optimistic given Egypt's relatively narrow industrial base, the scope of exemptions, and past difficulties with tax administration. In addition, on the expenditure side, the program calls for relatively firm control over the growth of noninterest current outlays. Nonetheless, the level of subsidies remains excessive. In this context, the authorities' price liberalization policy appears overly tentative, especially in view of the extremely large disparities between world and domestic prices that pervade the agricultural and industrial sectors.

I was also concerned that the public enterprise reform could provide a vehicle for simply placing expenditures off budget, rather than result in meaningful improvements in efficiency. For example, the programmed improvement in the fiscal position results partly from taking off budget public enterprise investment. Similarly, the fact that holding companies will be permitted to

cross subsidize enterprises may also artificially depress recorded fiscal subsidies. Finally, the experience of Eastern Europe suggests that the creation of holding companies will not result in meaningful efficiency gains until the domestic and external trade system is fully liberalized and public enterprises face increased competition.

The staff report also notes that the increase in the wage bill will be limited to 16.4 percent in 1991/92, while a 15 percent reduction in real expenditures is expected in 1992/93. I wonder whether the staff could elaborate on how these relatively ambitious targets will be achieved, given that, as we understand it, the recent introduction of the GST legislation was accompanied by an announcement of 5 percent bonuses for public employees as well as 15 percent increases in civil service salaries and pensions.

On the monetary front, the program's restrictive monetary growth target appears necessary, given the liquidity overhang that was created in 1990/91. However, despite a number of reforms to the financial system, I am concerned that the authorities are not yet in a position to implement monetary policy effectively.

First, the staff report's description of continued interest rate inflexibility casts doubt on the program's target for a virtual doubling of savings deposit rates. It would appear that despite a number of steps to introduce more market-oriented instruments of monetary control, important distortions remain in the interest rate structure, which will only begin to be addressed later this year.

Second, I was puzzled by the authorities' decision to restrict banks with excess liquid balances from bidding competitively at treasury bill auctions. The description in the staff report suggested that the authorities were concerned that if banks were allowed to bid freely at the auction, the interest rate would be bid to too low a level. In our view, it would seem more consistent with the goal of financial market reform to forgo such artificial and distortive constraints over bank behavior and simply ensure that the supply of treasury bills at the auction was sufficient to ensure the desired interest rate objective.

Third, we found it difficult to reconcile the target for private sector credit with the objective of increasing private investment. As bank credit to the private sector is expected to increase by only 14 percent in 1991/92, compared with inflation of 32 percent, real credit will decline markedly. I wonder whether the staff could elaborate on how the expected increase in private investment will be financed.

On the external front, we were also concerned about the apparent continuation of distortions in the exchange rate system. In particular, it is unfortunate that soon after the recent reform, which replaced the previous regime of three exchange rates with a dual exchange rate system, a third exchange rate has re-emerged. Moreover, we would assume that the balance of payments projections for the program period were, at least partially, predicated on the substantial depreciation of the Egyptian pound, which has only partially occurred. Like the staff, we consider it vital to eliminate the administrative constraints that have limited the participation of foreign exchange dealers in the free market.

Finally, we trust that the upcoming Paris Club discussions of Egypt's external debt situation will have a satisfactory outcome. Debt reduction can help in some circumstances to promote private sector confidence and a return to external viability, but not by itself. In our view, Egypt's growth prospects have been constrained, its external accounts have been eroded, and business confidence has been stifled largely as a result of inappropriate fiscal policies and pervasive administrative distortions. A reduction in Egypt's external debt, like the financial resources it has already received, can provide only a temporary window of opportunity to address these more fundamental issues. Therefore, we encourage the authorities to make careful use of this opportunity to accelerate the pace of structural reform.

With these comments, we can lend our support to the proposed decisions, and wish the authorities success in putting their economy back on a path of sustained growth and prosperity.

Mr. Yamazaki made the following statement:

At an informal meeting of Executive Directors in 1986, I was the first to express my very strong support for going ahead with the stand-by arrangement for Egypt. Therefore, I was very discouraged when I learned that, after only a short period of time, the program failed. Since that time, I have waited a very long time for the stand-by arrangement to be taken up again by the Board with the renewed determination of the Egyptian authorities.

Having said that, I would like to welcome most warmly the completion of the lengthy, indeed, very time consuming, negotiations between the authorities and the staff. I would also like to join previous speakers in commending the Egyptian authorities and the staff for their perseverance, trust--even in times of difficulty--and, above all, their strenuous efforts.

The arrangement before us is virtually the first program in the Middle East to be directly supported by the Fund since the

onset of the Middle East crisis last summer. The program is very well structured, comprehensive, and ambitious, and is blessed with the firm and courageous determination of the Egyptian authorities, in spite of the many domestic difficulties they have had to overcome. Therefore, I would like to express my very strong support for the program for Egypt, exactly as I did four and one half years ago, wishing--and, indeed, trusting--at the same time that this time the implementation of the program will be most successful.

The staff report is quite eloquent on the details of the program; therefore, at this stage of the discussion, I will refrain from going into the details. I welcome the staff's frankness in pointing out the strengths, as well as some of the weaknesses, of the program and the fragility of the Egyptian economy in the medium term. In the same vein, Mr. Finaish's statement, too, very clearly points out what is necessary for the authorities at this stage. In particular, I strongly believe that a determined tightening of fiscal and monetary policies is essential in order to contain the jump in prices that is projected for the coming fiscal year.

In a sense, the Egyptian economy is at a critical juncture. After long discussions with the Fund, the authorities are now taking positive steps toward a fundamental transformation of the economy. However, as Mr. Finaish noted, failure to contain the price increases below the program target will not only undermine macroeconomic stability but also endanger the successful implementation of the structural reforms needed for this economic transformation. Therefore, the authorities should make every effort to keep up with the fiscal and monetary targets in the program and should stand ready to take additional measures should the need arise. The necessity of persevering with the program is evident, especially in light of the fragile external situation projected for the medium term. The authorities should recognize the importance of successful implementation of the program in order to secure a more viable external position in the future.

Winston Churchill once said to Field Marshall Montgomery that there is no harm in saying the same thing over and over again, provided it is right. Accordingly, I would once again like to encourage the authorities to implement strictly the measures in the program and, when possible, speed up the pace of the transformation of the economic system.

With these comments, I support the proposed decisions.

The Deputy Director of the Middle Eastern Department recalled that Mr. Al-Jasser had wondered why the level of consumption of fuel oil, which amounted to 46 percent of total consumption by volume, was so high relative

to the consumption of other products. One of the reasons was that half of the electricity produced in Egypt was generated with the use of fuel oil. It was very difficult, without embarking on a major shift in the energy generation program, to switch from fuel oil to other sources of energy. The second and, in the staff's view, most important reason was that the price of fuel oil had been extremely low in Egypt for many years. Indeed, after the 100 percent increase in June 1990, the price of fuel oil was still only $0.09 per gallon, which was about 20-30 percent of the world price equivalent, calculated on the basis of ex factory prices. In order to correct that situation so as to reduce fuel oil consumption and increase consumption of natural gas, which was plentiful and difficult to export, two things had to happen: first, the price of fuel oil had to increase much more rapidly than the alternatives; and, second, the price of fuel oil had to be higher than the price of natural gas. The authorities were aware of those issues, and future energy generation plans would attempt to reduce the consumption of fuel oil and encourage the consumption of natural gas.

The agreement on the so-called energy price adjustment formula had, indeed, taken a long time to negotiate, the Deputy Director remarked. An energy price adjustment formula had first been discussed in the early 1980s. Clearly, the present formula was not perfect; it compared ex factory prices in Southern Europe with retail prices in Egypt; also, adjustments were made infrequently, as the authorities felt that they could increase the price of energy only at particular times of the year. Nevertheless, it was important not to lose sight of the broad picture, which was that domestic energy prices in Egypt were extremely low by international standards. It had been crucial, therefore, to agree on a mechanism, however imperfect, which would guarantee that, over time, energy prices could reach world equivalence. Once it had become clear that the staff of the World Bank was satisfied with the price adjustment provided by the formula, and that the adjustment would provide a certain amount of fiscal resources, the Fund staff had supported the formula.

The balance of payments projections were based on very preliminary statistics, the Deputy Director of the Middle Eastern Department stated. It appeared that, through March 1991, some items in the balance of payments had performed better than had been anticipated, such as tourism, oil exports, and revenue from the Suez Canal; information was not yet available on the performance of non-oil exports. It was possible that the projections for some of those items might be too pessimistic, as Mr. Landau had suggested; however, given the developments in the Middle East, particularly Kuwait and Iraq, which were the main destinations for Egyptian expatriate workers, those projections could be somewhat optimistic as well. The staff was less certain about the projections for the errors and omissions item in the balance of payments, which included foreign direct investment. Although the projection for that item might be considered low, some Directors had noted that the operations of the exchange market and the interest rate determination mechanism were currently somewhat hesitant, and, consequently, the forecast for the flow of private capital into Egypt would have to be cautious. Taking all those factors into account, the staff believed that the base scenario contained in the staff report remained appropriate.

Mr. Landau said that the staff's concern about the current account of the balance of payments was somewhat narrower than his own concern. Could the staff confirm his understanding that, taking into account the debt-reduction scheme and the capital resources that had been committed to Egypt during the Middle East crisis, there would be no overall financing gap through the end of 1992?

The Deputy Director of the Middle Eastern Department replied that, while there would not be a financing gap through 1992, it might be necessary, at the time of the midterm review under the stand-by arrangement and on the basis of the decisions of creditors in various forums, to revise some of the staff's estimates. When the balance of payments projections were prepared, the staff did not make any assumptions about the actions of any of Egypt's creditors, which would clearly have an effect on the balance of payments prospects.

The role of monetary reform, especially in controlling the process of dollarization in the economy, had concerned a number of speakers, the Deputy Director recalled. While it was true that an efficient interest rate mechanism was a crucial element in that reform, it was not the only element. It was also important to bear in mind that people kept their savings in the form of dollars because they wished to use them. Consequently, a properly functioning exchange system was equally important for the monetary reform to perform efficiently. Unless the two systems complemented one another, the dollarization process would continue; the program assumed that the process would continue in 1991/92, since the two systems were only in their infancy.

Preparations were already under way to complete the income tax reform before the end of 1993, the Deputy Director went on. The Fund had provided some technical assistance, and a team from the United States Agency for International Development was currently assisting the authorities with the reform. The issues were very clear; there was an obvious need to broaden the base of the personal income tax, the corporate income tax rates had to be reviewed, as some of the rates were too high, and there was an excessive number of exemptions that were no longer justified.

In light of the excessive liquidity of the four public sector banks, the staff was concerned that they could swamp the treasury bill market if they were permitted to bid at the treasury bill auction, the Deputy Director commented. For that reason, it was appropriate to maintain some restrictions on the ability of those banks to enter the process. Mr. Clark had wondered whether the amount of treasury bills offered at the auction could be varied to raise interest rates. However, the amount of treasury bills auctioned in the market was set to achieve the authorities' objective for reserve money programming and was not yet set in order to affect interest rates.

There had been some concern that, given the recovery of investment in the private sector that was envisaged under the program, the credit program for the private sector might be too tight, the Deputy Director of the Middle Eastern Department recalled. As noted by a number of Directors, the

definition of the private sector had been expanded, and there were a number of reasons why the staff believed that the credit program was appropriate. With the reform of prices, through price liberalization and decontrol, there was ample scope for the private sector to increase its profitability. Furthermore, if there was one element that the private sector had not been short of in the past, it was credit; credit expansion had been very generous, and the private sector had been able to build up its balances in the domestic banking sector. Moreover, the private sector had been building up its foreign balances. The international banking statistics showed that the nonbank sector of Egypt had increased its deposits with foreign banks by $1.5 billion during the past two years. The tightness of the credit program was, therefore, aimed basically at bringing back those resources. Finally, the staff had assumed a certain level of foreign investment under the program. For prudential reasons, it would be preferable not to inject too much liquidity into the system at the start of the reform program.

The staff representative from the Middle Eastern Department recalled that Mr. Landau had wondered why the implementation of the unified investment law was being delayed until 1993. It was the staff's understanding that there would be a thorough reform of the investment legislation, which would in effect put the public sector enterprises on a totally equal footing with the private sector, but that the authorities expected the process to take some time. In the meantime, the unified investment law, which was to have been presented to the People's Assembly by mid-May 1991, but was currently expected to be presented by the end of May, would be an important step in that direction, as it would remove most of the differences between the public and private sectors.

The phrase in the staff report that referred to the need for the assurance of continuous or permanent exceptional assistance from donors and creditors in order to close the financing gaps, the staff representative said, was not intended to offer the staff's view on the best way to proceed. It was merely a statement of fact that, in the staff's view, given the policies in place, the objectives of the program, and the existence of financing gaps, either continuous or permanent exceptional assistance would be required. It was not a policy statement. In that connection, the authorities had already approached commercial banks and certain official creditors on the basis of the program with the Fund to initiate the first steps in that process. Those contacts were expected to continue after the Paris Club meeting.

It was possible that debt relief from the Paris Club could provide Egypt with more resources than was necessary to close the expected financing gap, the staff representative continued. In order for such a situation to accelerate the prospects for growth, however, the debt relief would need to be accompanied by an acceleration of the implementation of measures under the program to remove bottlenecks, which, together with the financial constraint, were also constraints on growth. In any event, an important element of the first review of the program would be a discussion of the impact of debt rescheduling and debt relief and how they should be addressed in the program.

The estimate for sales tax revenue had been derived by the staff on the basis of a thorough analysis of the industrial production data that were available to the authorities, which admittedly were not very comprehensive, the staff representative from the Middle Eastern Department commented. Nevertheless, throughout its analysis, the staff had allowed for reasonably cautious estimates, which had resulted in an estimated net gain of about 2.1 percent of GDP, after accounting for a number of consumption taxes that were being eliminated at the same time. The staff was reasonably confident that the revenue estimates would prove to be accurate if the authorities were able to implement the sales tax; the U.S. Agency for International Development had indicated that the authorities would be in a position to fully implement the tax by the beginning of 1992. Although the domestic industrial base of the sales tax was rather narrow, that tax was also applied to imports within the same range of products; in fact, the yield in revenue from the taxation of imports was greater than that from the taxation of competing domestic products.

Mr. Fogelholm remarked that it was surprising that the trade balance was actually projected to deteriorate constantly until the year 2000, despite the implementation of exchange rate and structural reforms. Could the staff elaborate on the reasons for that projection and why the diversification of the economy would be insufficient to improve export performance relative to imports?

The Deputy Director of the Middle Eastern Department replied that the trade sector was starting from a situation in which the overall level of imports was about $12 billion, while the level of exports was only $3 billion at best. Consequently, a phenomenal rate of growth of nontraditional exports would be required to close that gap. It should be borne in mind, however, that Egypt faced tremendous constraints and oil production was expected to fall over the medium term. The program assumed a 10 percent increase in real terms in non-oil exports. While that projection was based on the staff's best understanding of current and future policies, it was conceivable that the projection was too optimistic. Obviously, if a number of the public sector monopolies that managed exports such as cotton, citrus fruits, and textiles, were disbanded, a much more rapid growth of exports could materialize. At the same time, however, a growing economy would also require the building up of a strong capital base--and, therefore, of capital goods imports--from a level that had been, if anything, depressed in the past.

Mr. Wright made the following statement:

I would like to join other Directors in congratulating both the Egyptian authorities and management on concluding the long and often difficult negotiations that have produced the comprehensive program now before us. I would associate myself particularly with what other speakers have said about the perseverance of the staff and the admirable detail and the clarity of its report.

There is no doubt in my mind that this is a comprehensive and realistic program, and I give it my full support. But it is also an ambitious one, which will require great determination on the part of the authorities to follow it through. Before the outbreak of the Middle East crisis, it was becoming very clear that action could not be delayed much longer. It is paradoxical that the crisis and its aftermath made it easier for Egypt to embark on a program of adjustment. The conclusion of this arrangement, presaged by the timely implementation of prior measures, demonstrates the authorities' intention to take advantage of this, and I am confident that they will be resolute in keeping up the momentum.

The importance of sustained commitment and complete compliance with the program cannot be emphasized too strongly, and I would echo the Chairman's remarks to this effect in his speech in Cairo last Monday. I am confident that the remaining financing gaps in the staff projections will be filled by appropriately generous debt relief, and it is to be hoped that finance from within the region will also play some part. I should point out that the generous treatment that is expected from Paris Club creditors will reflect the comprehensive nature of the program and the authorities' demonstrable commitment to thoroughgoing reforms. As the Chairman also pointed out on Monday, economic adjustment in Egypt will certainly take more than the 18 months covered by this stand-by arrangement. It is clear to me that continuing close involvement with the Fund will be required in one form or another, and performance under this program will be an important factor in determining further support.

Turning to the substance of the program, there is little I can add to the candid staff appraisal and what other speakers have said. I have only a few brief points of emphasis.

First, I fully endorse the staff's urging the authorities to accelerate wherever possible the pace of reform, to guard against adjustment fatigue and enhance creditor and donor confidence. Like other speakers, I can readily understand the imperatives that lie behind the choice of a relatively gradualist approach, but a gradual path is not necessarily an easier one; the opposite may well be true. That is why it is particularly important that the authorities move ahead quickly in areas where this is possible and not allow the impetus of reform to be weakened where gradualism is necessary.

Second, as the staff points out, a tight financial framework is imperative if the substantial liberalization of the economy is not to create persistent inflationary and balance of payments pressures. In the fiscal area, I urge the authorities to do all they can to reduce subsidies further, since they account for half the deficit. I also strongly agree with the staff's comments on

the need for strict implementation of the sales tax right from the outset. In the monetary area, positive real interest rates are essential to restrain monetary growth, finance the public sector deficit outside the banking system, and increase the leverage of monetary control by reducing the dollarization of the economy. In this connection, I understand the Deputy Director's comments about not permitting highly liquid banks to swamp the treasury bill market. But I tend to agree nevertheless with Mr. Clark that the current restrictions on participation in the treasury bill auction are a serious inhibition on the working of the market, and, like Mr. Clark, I remain unsure whether the monetary objectives of the program can be met with the present structure and--perhaps more important--the present scale of the treasury bill market. Also in the monetary field, I would urge the authorities to give thought to strengthening the banking system with foreign capital by allowing foreign banks to play a fuller part in the monetary and foreign exchange systems.

Third, I would hope that rather greater progress can be made in privatization than is presently envisaged. It is not clear to me that the interim step of establishing holding companies will be altogether helpful in this respect. There seems to be a danger that the benefits of independence may be offset to some extent by additional administrative complexity. I am concerned that the arrangements allow for interenterprise transfers within the holding company, which, it seems to me, may weaken financial discipline within individual companies. Perhaps the staff could elaborate a little further on the operation of these companies and comment on the logistical constraints on privatization.

Finally, the program's performance criteria are accompanied by very specific and asymmetric adjusters, which I very much welcome as a reflection of the tightness of the program.

Let me conclude by once again warmly welcoming this program, which, if rigorously implemented and supported by the international community, will indeed represent the beginning of a new era for Egypt.

Mr. Posthumus made the following statement:

In the Chairman's luncheon address to the American Chamber of Commerce in Cairo a few days ago, he anticipated a vote of confidence in Egypt in the Board today. He also said that one important aspect of Fund assistance is that it acts as a catalyst and helps mobilize financial assistance from many other sources. In the case of Egypt, there seems to have been a reversal of that process; indeed, the chemical process started before the catalyst was added, and substantial financial assistance has already been extended to Egypt before the vote of confidence.

I fully agree, however, with Mr. Finaish that the medium-term adjustment and reform program of Egypt is the culmination of a lengthy process of discussions and consultations between the Egyptian authorities and the Fund and the Bank. Indeed, Egypt has moved on many policy fronts and implemented important measures. To a certain extent, donors and creditors may be seen to have taken their decisions in response to the important measures Egypt has already taken and, in particular, the decision to aim for a fundamental transformation of the economic system.

The very substantial foreign assistance provided to Egypt has, of course, been extended to compensate for losses that the economy suffered as a result of the Middle East war. But the assistance has also given Egypt a chance that many other countries suffering such losses have not had, which is to carry out a strong stabilization program, together with what the staff calls a medium-term adjustment strategy, without unbearable hardship. Therefore, I hope that the authorities will use this unique opportunity. It should not be forgotten that the more gradual adjustment policy for which they have opted also means gradual improvement, and that the market process will not start if the conditions are only partially fulfilled.

The medium-term outlook, as estimated by the staff, is worrisome. I assume that this is so partly because the medium-term outlook is based on the present gradual adjustment strategy. External financing gaps remain very high, and a debt-service ratio of 30 percent is, in the Egyptian situation, certainly not sustainable. In addition, some of the projections look rather optimistic--for example, the projections for workers' remittances. Recent developments indicate the uncertainty of remittances as a source of external income, dependent as they are on the economic and political climate of the labor-importing countries.

The fiscal reforms focus on the revenue side, and revenue is projected to rise from its present level of 25 percent of GDP to 38 percent of GDP in 1992/93. However, much less attention is being paid to bringing down government expenditure, which is projected to decline only marginally. It is important to reduce the overall size of government expenditure. At nearly 50 percent of GDP, the proportion of government expenditure in Egypt is among the highest in the world. Its magnitude crowds out the private sector; it is revealing to find that almost 70 percent of gross fixed investments are investments of the public sector. Furthermore, I did not find in the staff report any targets for trimming down the civil service, which, one suspects, is of substantial dimensions.

An extensive subsidy system is another problem, especially subsidies on production inputs. Even after a sharp increase in

energy prices last year and a further increase that is scheduled for this month, the targeted prices will be only 46 percent of world prices. Subsidies for agricultural inputs--pesticides and fertilizer--will remain in place until 1992/93. Quite apart from the fiscal burden to which these subsidies contribute, their existence prevents correct investment decisions.

On financial policies, I would like to mention in particular interest rate policies. Arguing for increasing nominal interest rates in the present international climate is probably not a very popular position to take. But real interest rates in Egypt may become positive only in 1992/93, and will then still remain relatively low compared with international levels. This is a time horizon that Egypt can ill afford. In a world with a savings shortage, all efforts are needed to at least try to stimulate national savings.

In conclusion, while supporting the program submitted to us today, I urge the authorities to strengthen and accelerate substantially implementation of the package, in particular its stabilization element, even if this has not been agreed with the Fund. Otherwise, a higher level of access or an extended arrangement would really not yet be justified in my view following this stand-by arrangement.

Mr. Goos made the following statement:

I think most of the important aspects of the program have already been addressed by previous speakers, so at this stage of the discussion I have very little to add. But I would like to join my colleagues in welcoming the fact that management and staff have finally agreed with the Egyptian authorities on an adjustment and reform program, which goes a long way toward alleviating the concerns previously expressed by the Board about undue gradualism and the lack of comprehensiveness of earlier reform efforts. In the process of reaching an agreement, both parties have shown considerable flexibility, compared with their original positions. I am confident that the flexibility shown on the part of the authorities, if combined with vigorous and sustained policy implementation, will yield a significant improvement in the country's economic and financial prospects.

In this context, I was particularly heartened by the Chairman's comments this morning about the strong commitment of the authorities to the program and their willingness to go faster and deeper than envisaged in their letter of intent.. The willingness to do so and the readiness to adopt additional fiscal measures as needed, which is mentioned in the staff report, bode well for the future, as do the significant prior actions already adopted. They bode well in particular because they should help

bring about improvements in business confidence, investment activity, and per capita income levels, improvements that are badly needed in the difficult circumstances of the country. Moreover, it is to be expected that convincing adjustment and reform efforts of the authorities will contribute to an easing of the external resource constraint. My authorities, like others, are willing to work constructively in the Paris Club toward a substantial reduction in Egypt's external debt.

Let me conclude with a few observations. My first point is that I was somewhat puzzled to note that the commendable effort at fiscal adjustment envisaged for 1991/92 is expected to be accompanied by only a marginal improvement in the external current account deficit. This is especially puzzling considering that the deepening of the domestic recession that is expected for this year and the substantial reduction in foreign interest payments should be expected to reduce much of the pressure on domestic resources.

My second point is on exchange rate policy. I wonder why the Egyptian authorities, in opting for an essentially floating exchange rate system, have not opted for a system that uses the exchange rate as a nominal anchor. Moreover, while welcoming the intention to review the competitiveness of the exchange rate at the forthcoming program reviews, I was surprised that such a review was not undertaken during the recent discussions--at least there is nothing in the staff report to indicate that it has taken place.

My third point refers to the staff's cautioning against the use of higher than market prices in debt conversion operations. In keeping with the voluntary character of such operations, the staff should not get involved in pricing issues but, rather, leave them to the parties immediately concerned.

My fourth point is that I would welcome the staff's or Mr. Finaish's comments on the results of recent contacts between the Egyptian authorities and commercial banks, if any such contacts have already taken place.

Finally, on the structure of the staff report, I was certainly among those who encouraged the staff to experiment with the format of staff papers. But, frankly speaking, I would prefer that we keep the focus of the staff report on macroeconomic policy issues. That should also be brought out in the presentation of the issues: macroeconomic policy issues should be presented first, followed by the structural policy issues.

With these remarks, I can endorse the proposed decisions.

Mr. Kyriazidis made the following statement:

Egypt's request for a stand-by arrangement, which I welcome and fully support, is indeed an important event for both the Fund and the country's authorities. For the Fund, the request marks the conclusion of a negotiating process in which a considerable amount of the staff's time and effort has been invested. I believe that the staff should be commended for the ability it has demonstrated in maintaining an open and frank dialogue with the authorities over a number of difficult and complex issues, and I also wish to thank the Chairman for his personal involvement in this dialogue, an involvement which has been crucial for the positive conclusion of the negotiations. For the Egyptian authorities, the request for a Fund program marks not the conclusion, but the starting point of an important undertaking--the implementation of a courageous and wide-ranging economic reform program, which, I am sure, will not fail to improve the performance of the economy and lead to a more promising economic future for the people of Egypt.

The authorities now face an extraordinary task, which appears not much different, in terms of the necessary administrative and policy efforts, from the one faced by the governments of Eastern European countries. An added constraint, however, is that the Egyptian economy is far poorer in terms of productive capacity and income per head than the Eastern European countries, and that complicates matters considerably. In fact, the authorities will have to tackle simultaneously a formidable array of structural and macroeconomic problems. The staff is adamant on this point when it stresses that "the authorities are confronted with a need to address rapidly increasing domestic imbalances and an over-liquid economy, as well as to implement economy-wide structural reforms which have yet to reach a critical mass." I fully agree with this point.

As emphasized by Mr. Finaish in his interesting statement, the economic program proposed by the authorities appears to be a powerful tool with which to address the economic problems of the country. The program appears to be comprehensive and well designed, as it envisages the right mix and succession of policy measures. The challenge now is to implement the program not only without slippages, but also according to the envisaged schedule. Experience suggests that the success of programs that have an important structural reform content is usually determined by the timely and consistent implementation of the envisaged policy measures, and I would therefore strongly encourage the authorities to adhere strictly to the schedule of measures presented in the staff report. In this regard, I am encouraged to note that the prior actions agreed with the staff have been broadly implemented.

The problem of full and timely implementation is particularly important in the case of structural policies. The staff rightly highlights the possible dangers connected with the gradual approach chosen by the authorities, an approach that might result in insufficient initial results and lead to premature signs of adjustment fatigue. I certainly share this point of view, as well as the staff's recommendation that the authorities should stand ready to accelerate the pace of structural reforms, especially in the fields of energy pricing, tax reforms, and external sector liberalization.

However, I see another danger inherent in the authorities' gradual approach, namely, that it might lead to only partial and limited reforms, especially if the authorities, in the face of initial positive results of their policies, would consider excessive the cost of further reform efforts. I am aware that, for the success of the whole program, the danger of adjustment fatigue indicated by the staff is far more serious than the danger of achieving only partial structural reforms. Nevertheless, I believe that, in certain policy areas, such as the public enterprise reform and the tax reform, the danger of limited reform is a real one.

For instance, with respect to public enterprises, an initial improvement in their aggregate financial situation owing to the reform efforts might lead to the forgoing of the implementation of a full privatization program and the liquidation of nonviable enterprises. In the field of tax reform, an expansion of tax revenue following the introduction of the General Sale Tax might lead to the postponement of the introduction of a fully fledged value-added tax, which might negatively affect the growth of tax revenues in the medium term. Therefore, I would strongly encourage the authorities to implement fully, and in a timely manner, all the structural reforms included in the program, since only in this way can significant improvements in the general efficiency of the economy be achieved.

Regarding the macroeconomic aspects of the program, the importance of the reduction in the fiscal deficit and the observance of the limits on its bank financing cannot be overstressed, since, without firm control of these basic variables, it will be impossible to achieve price and trade liberalization together with a declining rate of inflation. It is clear that, under the present circumstances, the reduction in the deficit will have to rely mainly on revenue-enhancing measures. However, in their future policy agenda, the authorities should also include a reduction of public outlays in terms of GDP, especially subsidies and wages. In this regard, I note that a deficit-reduction strategy that envisages revenue-enhancing measures as a first step and expenditure cuts as a only second step naturally runs the risk of relying excessively on revenues, a

fact that would negatively affect the expected improvement in the economic performance of the country. Therefore, in this area as well, I would strongly encourage the Egyptian authorities to implement their program of reforms fully and completely.

Finally, on the external situation, I would stress the need to achieve a realistic level of the exchange rate, within a unified market, over the life of the program. The difficulties encountered by the new exchange market indicate that the authorities should remain vigilant in this area of the program and implement, as quickly as possible, all the possible measures to give the economy an efficient market. I share the staff's advice that the licensing process of nonbank dealers should be accelerated, and the treatment of their net open positions should be the same as those of bank dealers. The need to achieve a realistic level of the exchange rate is emphasized by the existence of financing gaps from 1991/92. While the Paris Club's intervention appears to be capable of closing next year's gap, the persistence of financing gaps in the medium term indicates that a realistic exchange rate policy and the avoidance of implementation slippages are essential if the need for exceptional financing is to remain at reasonable levels.

In conclusion, the authorities of Egypt are embarking upon a major effort of economic reform, which will be supported by the assistance of the international financial community. I am confident that the authorities will fully exploit this opportunity to give their country a more dynamic and efficient economic system.

Mrs. Sirivedhin made the following statement:

For many years, the Egyptian economy has been characterized by internal and external imbalances. Previous attempts to address the problems have failed, mainly because of the gradual and fragmented manner in which stabilization and structural policy measures were implemented, but also due, in part, to inadequate foreign financing. Now that international support is stronger, the authorities cannot afford to let the opportunity pass them by. Therefore, I welcome the adoption of a comprehensive economic and financial reform program, which is indeed long overdue. The Social Fund to help less privileged groups adversely affected by the adjustment process should help contribute to the sustainability of the program.

The program before us has rightly accorded much emphasis on strong demand management and appears to me to be a good first step toward achieving a long-lasting solution to the present state of deep maladjustment. Because widespread subsidies, price controls, and slackness in mobilizing resources in the government sector

were some of the factors that led to the distortion of the economy, a broadly based structural reform of the public sector is therefore appropriate. I welcome the implemented and proposed upward revisions of energy and services prices and the tax reforms, which are essential to the achievement of the estimated revenue increase envisaged in the program. However, in light of the shortfalls in raising revenue in the past, it is important to accompany these measures with efforts to improve the authorities' tax collection capabilities.

Crucial to attaining the fiscal objectives of the program is an improvement in the operations of the public enterprises; difficult as it may be, their operations need to be closely scrutinized by the authorities, and immediate corrective actions for any deviations are essential. I note that a new administrative structure of holding companies is envisaged. I share the staff's concern regarding problems that may occur under the new administrative structure.

I cannot help but notice that the authorities are placing great reliance on revenue increases to bring about fiscal adjustment. The fact that the program provides for corrective measures in order to address deviations and shocks without jeopardizing the fiscal objectives gives some comfort. If steps could be taken at an earlier stage to reduce expenditure components of the budget, however, this would help avoid slippages and ensure a more viable fiscal position in the longer term. It would, moreover, be consistent with the goal of scaling down the public sector, as emphasized by Mr. Finaish. In this context, the staff suggestion of streamlining less productive expenditures and subsidies is worth pursuing.

The envisaged improvement in public finances should reinforce measures to absorb the liquidity overhang. Notwithstanding this, however, much more needs to be done to improve the effectiveness of monetary instruments, particularly on account of the substantial inflationary pressure associated with the envisaged price liberalization. Measures to eliminate constraints on greater nonbank private sector involvement in the treasury bill auction, as suggested by the staff, is one area where greater effort is required. This, together with measures to encourage positive real interest rates and elimination of direct credit allocation, will certainly make resource allocation more efficient.

Finally, Egypt will continue to have sizable financing gaps. Any shortfall in foreign financing will put the economic program in jeopardy. Therefore, every effort must be made to ensure that the country's financing requirements will be met adequately and in a timely manner. The international community has an important role to play, but, needless to say, cautious debt management on

the part of the authorities and adherence to the adjustment program are also crucial to increase the confidence of both creditors and investors.

With these observations, I support the proposed decisions.

Mr. Dai made the following statement:

The Middle East crisis has exacerbated the economic difficulties that have been present in Egypt since the second half of the 1980s. Despite the substantial external assistance obtained from various sources, the overall economic picture in Egypt still looks grim and the difficulties remain daunting. Further exceptional international assistance, including debt relief, is called for. The economic and financial program introduced by the Egyptian authorities to address the country's economic weaknesses is comprehensive and courageous and deserves the Fund's support. I would join previous speakers in supporting the request for a stand-by arrangement by the Egyptian authorities. With regard to the program, I have a few general remarks.

According to the program, while a comprehensive reform is unfolding in various economic sectors, real output is forecast to fall further in 1991/92 to minus 3 percent from minus 1.5 percent in 1990/91, and will not recover until the mid-1990s, when it is projected to reach a growth rate of 3.3 percent by 1995/96. The declining output and its slow recovery are, in my view, matters of serious concern. Given a population growth rate of close to 3 percent, the negative impact of falling output on the economy and the program's implementation could be significant.

Moreover, as the programmed fiscal deficit reduction will depend primarily on the revenue side, the declining output will have an adverse effect on the fiscal revenue objectives, despite good prospects resulting from pricing adjustments. I wonder whether it is possible to place greater emphasis in the program on measures to accelerate the recovery of economic growth.

When we discussed the economic transformation of Eastern European countries, it was said that the slow recovery of economic growth was due to specific circumstances in Eastern Europe and that a drop in production and employment was inevitable. I wonder whether this conclusion is also applicable to developing countries in other regions, such as Egypt. It seems to me, however, that conditions and circumstances in Egypt are not the same as in the Eastern European countries, though some of the reform objectives, such as liberalization, privatization, and stabilization, are similar. Furthermore, given the low level of the present stage of economic development, the capacity to tolerate a drop in output

would be limited. Therefore, I believe that a reversal of the downward trend of output should be given sufficient weight in the program.

During the previous Article IV consultation, there was an argument about the appropriateness of the timing and pace of adjustment. This difference reappears in this year's consultation. The arguments on both sides are basically the same. The authorities argue that a faster pace of reform is not politically or socially possible, while the staff argues that a gradual approach is more costly. Each side has endeavored to strike a balance between the need to undertake reform and the pace at which it can be implemented. The fact of the matter is that it has always been the case that each side draws a different conclusion on the appropriateness of the pace according to its own cost-benefit analysis. There are no easy answers to the question of what should be the optimum practical pace and what the most objective and scientific criteria are on which to base a judgement.

However, in judging the appropriateness of a program, we firmly believe in "seeking truth from facts." As we are still in the early stages of mastering knowledge from significant systemic economic reforms, more experience as well as lessons drawn from practical applications are absolutely essential to avoid mistakes arising from the design and implementation of fundamental transformation programs.

After a year of experience with systemic reform in a number of member countries, it seems that people tend to become more pragmatic toward this issue. It is generally acknowledged that the task of reform is not easy. The process is more difficult and complicated than initially expected, and it will take time. In the case of Egypt, I believe that in designing an appropriate pace of structural adjustment and reform, it is unrealistic not to take fully into account the fact that the attendant cost must be kept at a level that is politically and socially bearable. I fully share the views expressed in Mr. Finaish's statement that, in charting the pace of structural reform, one has to keep the short-term output and inflation implications very much in mind.

It is noted that a swift positive response by the private sector is relied upon as an important element of the reform program. This, in turn, will depend on the re-establishment of business confidence. Nevertheless, business confidence cannot be expected to increase if medium-term constraints on the balance of payments are not eased. Constraints on the balance of payments, however, cannot be eased without exceptional external assistance, given the heavy debt burden, the large financing gaps, and the fragile external position. Therefore, it is evident that substantial and exceptional international support is indispensable

to the success of Egypt's program. I fully agree with the staff in emphasizing the importance of continuous or permanent exceptional assistance from donors and creditors and in calling for a positive response from official and other creditors to Egypt's request for exceptional debt relief. It is expected that the needed support can be assured from the major creditors. I believe that the approval of the Fund-supported program requested by the authorities will facilitate the provision of further international assistance.

Mr. Végh made the following statement:

We welcome the staff report for the Article IV consultation with Egypt and the request for the stand-by arrangement after such a long process of negotiation. Let me say at the start that Egypt's program under the stand-by arrangement is not a strong one. It has, however, several positive aspects that merit its approval. I will refer first to the positive aspects and then I will comment on the main weaknesses of the program.

It is important to remark on the progress represented by the change in attitude of the Egyptian authorities in relation to the economic policy advice given by the Fund. This progress is more noticeable in the monetary and exchange areas. While in the past the authorities believed that the levels of interest and exchange rates could be better established through government policies, the present program recognizes the advantages of letting the market fix those levels. Although the latter policy is finding problems in its implementation, it is very important that it has been accepted. This acceptance has certainly helped to arrive at a successful conclusion of lengthy negotiations.

Notwithstanding the need for more improvement, the fiscal situation is another area where remarkable progress is projected. The fiscal deficit for 1991/92 is projected at half the level for 1991/90 and it is expected to be further reduced in 1992/93 to 6.5 percent of GDP, which, compared with the present deficit of about 20 percent of GDP, represents a considerable improvement. Although the thrust of the adjustment will be on the revenue side, expenditure will also be reduced, particularly through the cutting of food and fertilizer subsidies. There are, moreover, several contingency measures to provide for any adverse impact on the budget results.

Before turning to my basic comments, let me ask the staff two questions about the budgetary impact of the "once-and-for-all" outlay to recapitalize four public sector banks. How can we be certain that, in the future, the same need to replenish these banks' capital will not appear again? Are these four banks the only ones that need to be supported, or are there more banks in a

similar situation? These questions concern me, since experience shows that the replenishment of capital of public enterprises, and especially state-owned banks, is a recurrent and not a unique event. The only permanent solution seems to be to privatize or close these banks.

Turning now to the weak points in the program, like Mr. Dawson and other Directors, I agree with the thrust of the staff report and its recommendations, particularly those referring to the slow pace of progress and the tendency toward the gradualist approach. Time is the most scarce of natural resources and is clearly a nonrenewable resource. If this is true of physical time, it is even more true when referring to political time. Thus, it is worrisome to find in the staff report, in the description of government economic policy and the timing of targets, many references to 1993 or 1995 as the expected dates for making decisions on crucial ingredients of the policy mix. I am afraid that the Government may not have that much time and that, as is argued in the staff appraisal, adjustment fatigue may set in before a critical mass of action is reached. For this reason we encourage, the authorities to accelerate the velocity of change.

One of the uncertainties of the program is the transformation of the public enterprise sector. None of the measures to be implemented seem to be sufficiently strong. The creation of holding companies for public enterprises or the existence of a new regulatory law that will apply equally to both private and public sector enterprises do not guarantee efficient management. These are the kind of actions that have failed in many other cases and have resulted, contrary to the best intentions of government policy, in a strengthening of the independence of these enterprises from budgetary control, consolidation of their monopoly power, and abuse of the final consumer.

The privatization measures will not have any major impact, since they are limited to small companies. We should not be misled by the impressive number of small companies to be privatized; 2,000 privatizations will mean very little to the extent that the core of the productive process remains in the public sector.

The monopolistic market structure in which public companies operate represents, as has already been mentioned, a serious problem. I have not been able to find in the program, however, any reference to direct measures addressing the elimination or regulation of monopolies. The recently granted freedom to set salaries and prices in such a context represents a worrisome aspect from the point of view of inflationary pressures. Moreover, this public monopolistic context may overcrowd the credit market, making it difficult to achieve the 25 percent programmed credit expansion to the private sector in 1991/92.

The opening of the Egyptian economy to private capital could be a way to break the monopolistic structure of the economy. The long list of products that still need governmental approval for investment is, however, discouraging.

On trade policy, I also feel that the process of liberalization is too slow to provide significant benefits in the medium term. On page 15 of the staff report, there is a reference to a tariff level in a range of 10-80 percent by mid-1992, with some exceptions. Such a range does not correspond to an even moderately open economy. High tariff barriers and wide dispersion aggravate the problems of the monopolistic structure and distort the allocation of resources.

Finally, I am also greatly concerned about the importance of reaching balance of payments viability without exceptional financing in the near future. The line of reasoning is rather similar to that argued in the case of internal adjustments. There is the danger of fatigue, which, in the case of external equilibrium, is related to what has been called "donor fatigue." We can see today some symptoms of this fatigue, and I am sure that it will become more widespread in the future. It is not only a matter of psychology and expectations of governments and taxpayers; it is also, as I have argued in the Board discussions on adjustment in the Eastern European countries, a matter of numerical consistency in the budgetary projections of the large industrial nations. In this context, I was quite interested in the exchange between Mr. Fogelholm and the Deputy Director of the Middle Eastern Department on the matter of "permanent exceptional assistance." Like Mr. Fogelholm, I am rather surprised by this expression, which I think is a contradiction in terms: if a financing scheme is permanent, it cannot be exceptional; if it is exceptional, it cannot be permanent. In his answer to Mr. Fogelholm on this point, the Deputy Director said that the statement in the staff report was a statement of fact, not a value judgement or a policy recommendation. If this is so, I take it that the staff does not disagree with the substance of Mr. Fogelholm's observation.

We support the proposed decisions.

Mr. Mwananshiku made the following statement:

This chair is in agreement with the thrust of the staff report and supports the request for a stand-by arrangement.

The current reforms in Egypt accelerated in April and May with the introduction of the General Sales Tax, broadening of the tax base, tariff reforms, further price liberalization, exchange reform, and other aspects of monetary reform. These measures are

positive signs of the authorities' commitment to reform, and, given the difficult circumstances in which the reforms are being implemented, the authorities deserve the support of the Fund and the international community.

However, the authorities will have to persevere in their endeavors, paying particular attention to measures that would further improve the fiscal situation and the functioning of the exchange system. Fiscal consolidation and a properly operating exchange system are crucial to the success of Egypt's stabilization efforts.

The Egyptian program is another case that argues for a more dynamic debt strategy. Even with strong domestic action, the balance of payments scenarios show a huge financial gap through the year 2000 in the absence of further substantial debt relief. The staff has made a pointed case for a permanent reduction in debt-service obligations in order to enhance the prospects of achieving a viable balance of payments position in the medium term and to help improve private sector confidence, which would lead to increased investment and growth. It is important to note that this assertion applies not only to Egypt but also to many other heavily indebted countries that expect to benefit from modifications to the debt strategy as applied to Egypt.

On a matter of presentation, I note that in the balance of payments scenarios, foreign direct investment is lumped together with errors and omissions. I wonder whether, for an economy like that of Egypt, it would not be more useful to analyze these items separately.

Finally, I would like to commend those countries that have canceled the debts owed by Egypt and those that are providing generous financial support to alleviate the effects of the Middle East crisis.

I wish the authorities a successful program.

Mr. Torres made the following statement:

As the staff very well points out in staff report, "the Egyptian Government has initiated a promising medium-term adjustment strategy" that will allow it to address its economic difficulties in a very comprehensive manner. Although strong efforts to set the basis for economic growth were made in the past, they were characterized by fragmentation and lack of coordination within the various aspects of the program in a context of expansionary financial policies. It is only now that the Egyptian authorities seem to have achieved the momentum and consensus to implement a comprehensive and well-balanced economic

adjustment program. The efforts made by the Egyptian Government up to now, as well as its commitment to the medium-term adjustment program, deserve our commendation and support.

In our view, this process of reform embarked upon by the authorities calls for a strong commitment, by not only the authorities themselves but also the international financial community. On the one hand, the implementation of stabilization and structural reform measures, which is at present extremely gradual, needs to be accomplished in a timely, if not accelerated, manner so as to create the economic conditions to regain economic growth and restore business confidence. On the other hand, any effort made by the authorities cannot be successful without the extraordinary support of donors and creditors.

We note with concern the high levels that the fiscal deficit has reached in the past, and we welcome the authorities' intention to reduce the deficit rapidly from its high level of 20.9 percent of GDP in 1990/91 to 10.3 percent of GDP in 1991/92 and 3.5 percent of GDP by the middle of this decade. To this end, the authorities have embarked upon a strong, long-lasting fiscal reform that deserves our commendation. This reform, which is well explained in the staff report and its supporting documents, is the key element of the financial program, for which strong prior actions have been taken, and we expect that the stance of adjustment will continue in the next few years.

It is satisfactory to learn from Supplement 2 of the staff report that Egypt broadly met the prior actions required under the program. Nevertheless, it is somehow discouraging to learn that the General Sales Tax, as approved, differs from the draft proposal that was discussed with the staff. In considering the fact that the staff sees no need to revise the revenue estimates at this moment, we would like to stress the need to monitor developments closely in this area in order to tackle, as soon as possible, any deviation that may occur in tax collection. Moreover, it is worrisome to see from the same supplement that there are "pluses and minuses for individual items in comparison with what had been expected during the recent staff mission." Together with the revenue shortfalls experienced during the first quarter of 1991, this is a cause for concern, which calls for the commitment of the authorities not to relax their efforts but to strengthen them.

Another source of concern, in our view, is the acceleration of monetary expansion that occurred during the first months of this year. Actions taken in this area need to be urgently strengthened so as to avoid higher inflation levels that could jeopardize the whole program.

We welcome the movement toward exchange rate unification as well as the plans for unification by the end of the program period. However, to avoid excessive inflationary pressures, we would like to caution the authorities on the need to maintain close control over fiscal and monetary policies with the purpose of avoiding any unnecessary slippages.

Egypt's external position remains extremely weak over the medium term, owing mainly to the constraints imposed by the high ratio of external debt to GDP. We concur with the staff that debt relief resulting in a permanent reduction of external debt-service obligations will result in higher economic growth as well as positive private capital movements. In this regard, we hope that a satisfactory outcome will be achieved in the next Paris Club meeting on Egypt, and that the need will be stressed to tie the exceptional external assistance to a strong commitment by the authorities to the adjustment and reform program.

In concluding, I would like to commend the Egyptian authorities for their strong efforts and encourage them to continue. We feel that the present momentum should be exhausted in the sense of implementing, to the extent possible, all the measures needed to keep the program on track over the medium term. Experience has shown that the longer adjustment is delayed, the more difficult it is to maintain the strong stance shown at the beginning of the reform period. We support the proposed decisions.

Mr. Bindley-Taylor made the following statement:

Like many other chairs around this table, we wish to congratulate the staff and the Egyptian authorities for the successful conclusion of the substantial and lengthy negotiations for this stand-by arrangement.

We are deeply impressed by the Egyptian effort at structural adjustment, the range of measures already taken, the number of additional measures yet to be taken, and the coverage of the current reforms. They have been most ably presented in the staff report and in Mr. Finaish's excellent statement. Therefore, we can support the proposed arrangement. We do, however, have a few remarks on the macroeconomic aspects of the program.

In the fiscal area, the large fiscal deficits are to be addressed mainly from the revenue side, and we welcome the measures taken to improve the revenue/GDP ratio by 5 percentage points of GDP in 1991. We are also heartened that the sales tax, after some delay, was finally introduced at the beginning of this month. Despite these efforts, the overall deficit is expected to increase. One cause of that increase is the sizable increase in

interest payments, which we believe requires some explanation from the staff in view of the debt-service reduction already granted to Egypt. There are, of course, other causes of the increasing deficit, namely, a large one-time transfer for recapitalization of public sector banks and special restructuring outlays for certain state enterprises. However, the fiscal effort in the years 1991/92 and 1992/93 is aimed at reducing the overall deficit to a level of 6.5 percent of GDP by the end of 1992/93, and we urge the authorities to follow faithfully the revenue-raising and expenditure-reduction plans as indicated in their financial program.

Tight monetary policies are essential to the success of the program, and we welcome the more active use of the sale of treasury bills and bonds. The eventual reduction in the fiscal deficit should allow for greater credit expansion to the private sector and thereby promote the entrepreneurial activities of this sector. However, care must be taken not to compound the price increases caused by price liberalization and the adjustment in the exchange rate by too much monetary expansion. In this regard, we perceive the current negative real interest rates and the liquidity caused by the inflows from donors as sources of potential danger, and we urge the authorities to act quickly to establish interest rates that are positive in real terms and to use market-determined instruments to mop up surplus money balances.

We welcome the move to restore competitiveness by abolishing the previous exchange rate system. We are concerned, however, that the established primary rate in the new and temporary dual exchange rate system might still be overvalued. We urge the authorities to act promptly to avoid any overvaluation and are pleased to note in Supplement 2 of the staff report that the primary exchange rate has been allowed to follow the secondary market rate to a more appropriate level.

In support of these efforts at stabilization, there have been tremendous complementary efforts at structural reform. These reforms cover the broad spectrum of privatization, removal of investment and price controls, public enterprise reform, and reforms in the trade, financial, and foreign exchange systems. We support the reforms introduced in public enterprises to give them full autonomy and to subject them to the financial discipline of the market. However, we urge the authorities to speed up both the drafting and promulgation of the "unified law."

We welcome the efforts at price liberalization of public sector goods and services in the agricultural, energy, and transportation sectors. However, we would ask whether the prospective time frame could not be accelerated. Naturally, there will be unavoidable costs in the liberalization process, and we

therefore warmly endorse the authorities' establishment of the new Social Fund to protect the standard of living of the lowest income groups.

Significant efforts are being made with respect to trade liberalization, and we welcome the steps taken by the authorities with respect to reducing the coverage of import bans, the rationalization of the tariff structure, and the reduction of the list of products requiring prior import authorization.

Regarding the medium-term outlook, exceptional financing has effectively strengthened the balance of payments position in the current year, but financing gaps remain from 1992/93 onward even under the comprehensive adjustment scenario. Therefore, it is clear that substantial external assistance will continue to be required, and we urge donor countries and creditors to respond positively to Egypt's need for exceptional debt relief and additional financing. We also believe that Mr. Finaish's suggestion that Egypt be considered among those eligible for ESAF resources should be favorably entertained.

With these remarks, we wish the authorities well in this most challenging task of attaining viable economic growth in the near future.

Mr. Fernando made the following statement:

We commend the authorities for building up sufficient resolve to cross the threshold from program negotiation to program implementation, and we commend the staff for its perseverance and painstaking effort in crafting a program that merits the Fund's financial involvement. The long, but well-researched, agenda of action makes the current stage only a beginning. Just as the authorities should demonstrate their cooperation through steadfast adherence to the principles and concepts underlying the program, the Fund, too, as suggested by the "third pillar," should meet its obligations adequately and in a timely manner.

The balance of payments projections for the medium term and the staff comments thereon clearly show that, even with the authorities' full commitment and steadfast implementation, substantial financing gaps will prevail. More than the arithmetical interest of balancing the accounts, what is of greater importance, in terms of its impact on the program, is what those gaps do to business confidence. While sound economic and financial policies can create the capacity and incentives for private initiatives, business confidence, if it is to be revived on a durable basis, will require some assurance that the burden of the dead weight of past debt will not fall on the entrepreneurial sector. We fully support the staff call for effective debt relief

to sustain the policy effort over several years. Indeed, given the clarity with which the medium-term scenario is presented, the endorsement of the program in its initial stage by the Fund, Bank, and the international community would form the basis of an expectation that continued debt relief and financing support will be forthcoming to sustain the adjustment momentum. The specific pledges of support heard thus far are encouraging. The Fund should also stand ready to underpin its policy advice with financing support. The low level of access for the current stand-by arrangement and the Fund's low exposure to Egypt provide some latitude for future financing.

With respect to the financial sector, even after an expenditure of 6.5 percent of GDP to recapitalize the public sector commercial banks, a serious underlying problem remains. Judging from Appendix VII of the staff report, the recapitalization exercise has taken care of the banks' foreign exchange losses. However, the magnitude of nonperforming debts is unknown, and, hence, the issue of solvency of the banks is wide open. The totality of circumstances suggests that nonperforming debts could be an impediment to financial sector reform as well as monetary policy more generally. Would another recapitalization be called for? In the same vein, if public sector banks presently carry a load of nonperforming debts at a time of negative real interest rates and low nominal interest rates, would the situation not be aggravated as interest rates take off--as they will when demand-management policies start biting? The staff's comments on how it views this problem would be helpful. Specifically, we would like to know whether a secure legal basis exists for loan recovery. The removal of the government guarantee on bank loans would help to improve the quality of credit decisions; so would the directive concerning capital adequacy in terms of risk-weighted assets. However, on provisioning, does the Central Bank have the capability of enforcing the provisioning guidelines, and does it have sufficient legal authority and administrative capability to supervise commercial banking operations?

On the balance of payments projections for the medium term, we note the steady increase in the value of imports, from about 5 percent in the coming two years to 8 percent in the following two years. As output is expected to contract in 1991/92 and pick up only modestly and gradually thereafter, some clarification as to the rising import value would be helpful, particularly in view of the size of the financing gaps, which are driven as much by the trade balance as by the debt burden. Admittedly, projections are hazardous in an environment characterized by pervasive controls, as the past can be a poor guide to the future. Also, the inherent uncertainties in the response of consumers and economic agents to import liberalization should be borne in mind. Hence, complementary policies and sufficient latitude for action are crucial to keep the situation stable and manageable. We would

underline, however, that the best antidote for these kind of risks is policy credibility--in this instance, a forward-looking and specific time-bound program that demonstrates that the liberal policies are there to stay and will be progressively liberalized. The present situation of comfort in international reserves is too fragile to be squandered through any laxity in the policy matrix.

We support the proposed decisions.

Mr. Evans stated that he wished to join other speakers in complimenting the staff, management, and the authorities on reaching an agreement on a Fund-supported program, and he associated himself in particular with the concerns expressed by Mr. Fogelholm, Mr. Clark, and Mr. Végh. It was clear that the Egyptian situation called for more than a stand-by arrangement. Nevertheless, the proposed stand-by arrangement was an important first step, and performance under that arrangement would determine whether there could be a successor arrangement.

He wondered whether the performance criteria were sufficient to ensure that the program would be implemented as intended, Mr. Evans remarked. As in most programs, fiscal policy was the key element, and the fiscal requirements of the Egyptian program were very demanding. However, there was no direct fiscal indicator included among the performance criteria; there were limits on the banking system's financing of the public sector, but those limits would not always constrain public sector deficits. He wondered whether there was any reason for not including an explicit fiscal indicator in the program and whether the staff could see any merit in doing so at a future review under the stand-by arrangement.

Mr. Kural made the following statement:

Egypt has experienced two periods, each a decade long, when its growth rate was among the highest in the developing world. The decade between 1956 and 1965, a period of strong public sector intervention, witnessed the modernization of infrastructure and a radical restructuring of the economy. During the second decade of growth, from 1973 to 1984, the economic liberalization that was launched when GDP growth reached 8.5 percent exposed Egypt's economic and social structures to sweeping changes.

Since 1985, however, these favorable economic trends have reversed. With the sharp drop in oil prices during the last half of the 1980s, Egypt's balance of payments situation began to falter and its economic structures began to weaken. The disturbances of the present period thus reflect the effects of the end of the oil boom, Egypt's severely distorted production structures, a large accumulation of foreign debt, and increasing dependence on the outside world.

Moreover, Egypt found itself in a special position vis-à-vis the Middle East crisis: of all the many countries affected by that crisis, conditions unique to Egypt caused it to suffer the severest damage. These losses have now been largely offset by the GCFCG, and the stage is set for a comprehensive reform program.

Although it was possible during 1990 to maintain Egypt's financial viability through debt cancellations and grants related to crisis assistance, the country's debt problems in 1991 remain unsolved. Egypt's borrowing possibilities are still severely limited, and its external debt will have to be rolled over in a very unfavorable financial climate. In other words, the Egyptian economy suffers from financial constraints that originated years ago.

For the immediate future, Egypt's favorable balance of payments position will permit some relaxation of the anti-inflationary policies that also restrain growth, but in the medium term, an expected worsening of the balance of payments will combine with upward pressures on the fiscal deficit to reduce the room for maneuver against inflation and will require the resumption of restrictive policies unfriendly to growth.

I will comment on two aspects of the Egyptian economy: first, public enterprise reform and privatization, and, second, monetary reform.

The staff is correct that revenue measures are essential to support the public enterprise reforms, and the authorities are wise to take prior actions in the form of imposing a sales tax, restoring customs tariffs, and proposing adjustments in the prices of domestic energy, basic inputs, and consumer goods. The staff is again correct that privatization policies will penetrate the Egyptian economy in both the service and commodity sectors, though they may develop only gradually. This process might be speeded up through efforts to change public attitudes and behavior by presenting popular explanations of these reforms and their objectives. The new policies decontrolling private investment should build the confidence of lenders and investors in Egypt's new private sector. Increased confidence and creditworthiness will encourage private investment decisions and speed the process of the privatization of public units. Could the staff comment on the performance to date of Egypt's private sector and on its present share in the Egyptian economy?

In the monetary sphere, though treasury bill rates have risen from 14.5 percent in January to 17.5 percent in early April, interest rates remain negative in real terms. The normal result of negative real interest rates should be a decline in real money demand and a rise in currency substitution. Currency substitution can be restrained or reversed and real money demand increased by

removing the present ceiling on deposit rates. Removing this ceiling would have the further advantage of increasing the less liquid components of the money supply, such as time deposits. It would, however, be necessary to avoid too steep an increase in the volume of deposits and the cost of loans, which would combine with a reduction in credit demand stemming from a slowing of economic activity to make it hard for the private sector to transform its funds into loans. Could the staff also comment on this issue?

In sum, Egypt's losses stemming from the Middle East crisis are obvious. They threaten to prevent the observance of macroeconomic targets, and if the structural adjustment process were to be derailed, it would not be easy to get it back on track for the longer term. For this reason, it is essential to provide timely relief to keep Egypt from losing the headway it had made by its strenuous efforts before the crisis. If preserved, the momentum Egypt had gained prior to the Middle East crisis could enable the country to achieve longer-term viability without needing further concessional assistance, provided, of course, that Egypt's medium-term adjustment policies are implemented very carefully henceforth to prevent the dragging on of present difficulties and the emergence of new ones. Therefore, I support the proposed decisions.

Mr. Santos made the following statement:

Like previous speakers, we are pleased to note that after lengthy negotiations, the Egyptian authorities have been able to reach an agreement with the Fund's staff on an ambitious and comprehensive program of adjustment, which, if fully implemented, could go a long way in stabilizing the economy and putting it back on a sustainable growth path over the medium term. However, as clearly indicated in the staff report, in view of the magnitude of the imbalances and the heavy debt burden, even with a strong and sustained implementation of the program, its intended objectives would not be achieved in the absence of substantial and continued external financial support. In this respect, further debt relief will be required to bring down Egypt's debt indicators to more manageable levels and improve prospects for raising per capita income.

We find appropriate the authorities' strategy aimed at decontrolling investment and liberalizing economic activity so as to promote the private sector's role and induce a more efficient and productive economic system. Also appropriate is the authorities' commitment to secure a stable macroeconomic environment conducive to noninflationary growth, higher investment, and higher levels of national savings. Since I can associate myself with most of the comments made by previous speakers and can endorse the staff appraisal, I shall be brief,

focusing the rest of my statement on three aspects of the program that I consider to be critical for its success, namely, fiscal adjustment, the sequencing of the reform measures, and the creation of safety nets.

First, on fiscal adjustment, we are encouraged to note that the program envisages a substantial fiscal retrenchment--of the order of about 10 percentage points of GDP in one year, as the overall deficit of central and local governments is expected to decrease from about 21 percent of GDP in 1990/91 to 10.3 percent of GDP in 1991/92. Even after adjusting for the effect of the recapitalization of the four public sector banks, the magnitude of the fiscal adjustment is still impressive by any standard. Equally impressive are the wide-ranging fiscal measures detailed in Table 5 of the staff report. To achieve the ambitious deficit target, it is of paramount importance that these envisaged measures are introduced in a timely manner. In this regard, we welcome the package of courageous measures already implemented at the beginning of May, and we would urge the authorities to persevere in the implementation of the measures and keep developments in the fiscal sector under close review.

Second, on the sequencing of the reform measures, we, like the staff, consider the structural reforms to be the cornerstone of the adjustment process. Given the scope of these reforms, it is clear that their careful sequencing is critical for the success of the whole process. While we see merit in the staff's recommendation for an acceleration of the reforms in order to reach a critical mass of action, we share the Egyptian authorities' view that a pragmatic approach is warranted. I agree that the authorities should persevere with sound policies and reforms for several years and not allow the impetus of reforms to be weakened should occasional setbacks occur.

Third, on safety nets, we welcome the creation of a social fund to mitigate the obvious consequences or hardship that the program will impose on some groups of the Egyptian population. The objectives of that fund are commendable. In particular, we find noteworthy the efforts toward limiting the impact of the reduction of direct food subsidies on vulnerable groups and the financing of job mobility and retraining programs. Similarly, the role that regional donors are committed to play in the financing of essential infrastructure, such as schools and hospitals, is most welcome. These safety net programs appear to us to be an essential component in gathering the domestic consensus for the implementation of the authorities' program of adjustment.

Finally, there is no doubt that the program before us represents a considerable challenge for the authorities. Its success will depend not only on the authorities' determined and sustained efforts but also on timely and substantial external

assistance and, in particular, exceptional debt relief. We support the proposed decisions.

The Deputy Director of the Middle Eastern Department said that the newly established holding companies operated in the middle tier of the organizational structure of public corporations and performed several tasks, such as reviewing, improving, and following up on the implementation of the business plans of public corporations on the basis of pro forma financial statements. Initially, the staff had had some concerns that the holding companies would act as an additional layer of bureaucratic control, but it had been assured by the staff of the World Bank that that would not be the case.

There were basically two logistical constraints on the privatization process, the Deputy Director commented, the first of which related to the regulatory environment. The staff would prefer to see a much faster pace in the decontrol of licensing of investment, as well as a change in the labor legislation so that private and public companies were given the freedom to manage their own labor policies. While companies currently enjoyed that freedom in a de facto manner, until the legislation was changed, there was always a risk of moving backwards. In addition, there were a number of restrictions on the role of private foreign investment. The second constraint on the privatization process centered on the authorities' existing policy stance, as there was still a considerable degree of discrimination against the private sector, such as differential access to supplies and differential import and capital costs. In the staff's view, there was a need for further trade liberalization, not only domestically but also with respect to the various constraints on Egypt's exports, such as quotas and outright bans in some extremely promising sectors, including the textile sector. There was also considerable scope for further measures to correct the role of monopolies, which permeated the economy. Finally, successful privatization required banks to play their traditional role in mobilizing savings, and, in addition, there was a need for the creation of a fully functioning capital market. There were a number of constraints of a legalistic nature on the proper functioning of a capital market, and there was also a set of policies that prevented the creation of mutual funds, such as ceilings on the interest on newly issued bonds and tax legislation that basically penalized shareholders.

The question had arisen whether the staff was confident that the available instruments of credit control would help to reduce the pace of credit expansion, the Deputy Director recalled. Obviously, the pace of credit expansion could be reduced only if, in the first instance, the fiscal targets were closely adhered to. While the staff had initially thought that it would be appropriate, as a complement to the treasury bill auction, to move toward indirect instruments of credit control, such as those related to the operation of the Central Bank's balance sheet and those influencing the liquidity of banks, it had become clear that, for technical and other reasons, it would have been premature to experiment with new credit techniques at the start of the program. Therefore, the authorities had to rely on traditional credit instruments, although there was ample scope to

use interest rates and a more forceful variation of the reserve requirement. The staff had been somewhat surprised that interest rates had not increased further, especially given the acceleration in the rate of inflation. The staff had also been surprised by the behavior of the banking sector, as commercial banks were not following the developments in the treasury bill market.

A considerable amount of disorder had been created in the treasury bill market by the confusion surrounding the taxation of yields, the Deputy Director went on, as it had been unclear for a long time whether those yields would be taxed. If they were to be taxed, the implicit rate would be 60 percent, which was extremely harsh. While that issue had recently been resolved, it was still necessary to offer the nonbank public complete access to the treasury bill auction before order could be restored in the treasury bill market. The interest rates offered by banks tended to deviate from the behavior of interest rates in general, because the banks had a large amount of fixed, low interest rate loans in their portfolios and banks carried a number of nonperforming loans on their balance sheets. Consequently, to the extent that bank deposits were not being redirected into treasury bills, the banks felt relatively comfortable in keeping deposit rates at the current low levels, although it seemed that the situation might be changing. If more funds were introduced into the treasury bill auctions, it was expected that a move in commercial banks' deposit rates would follow; the past two or three auctions had been fully subscribed and rates had tended to rise. In addition, the Central Bank was using traditional credit instruments, such as strict credit limits on the expansion of private sector credit. Accordingly, there were grounds for believing that the credit program would be observed.

A few Directors had wondered why the substantial reduction in the fiscal deficit was not paralleled by a corresponding reduction in the trade or current account balances, particularly since the economy was depressed, the Deputy Director noted. It should be recognized, however, that not all sectors of the economy were depressed, and the fall in GDP was largely concentrated in the public sector. The adjustment in the current account deficit would have to take into account the high level of demand from the private sector for imports, which was related in part to the newly established exchange system, trade liberalization, and investment decontrol.

With respect to the exchange system, the Deputy Director continued, Mr. Goos had asked whether the staff had discussed with the authorities the possibility of using the exchange rate as a nominal anchor. The staff and the authorities had discussed a number of exchange systems; the current system was chosen because it was fairly liberal and included the broadening of an element from the previous system that was functioning relatively well, namely, the "own" exchange market. The appropriateness of that decision was demonstrated by the fact that the current system had been accepted by market participants. In order to move to a nominal anchor, moreover, the appropriate fiscal and financial policies must be in place, and, at the time, it was unclear whether those policies would permit such a move.

The staff report was organized so that structural measures were dealt with first, because the design of the financial program was built in the context of the structural changes, the Deputy Director stated. Nevertheless, Directors could be reassured that the staff did not consider that macroeconomic policy issues played a secondary role; the two issues were complementary, and the fact that macroeconomic issues were dealt with at the end of the staff report was not meant to imply that they should be given less prominence.

A number of questions had been raised about whether the recapitalization of the banks was a once-and-for-all event or whether there would be a need in the future for further bank recapitalization, the Deputy Director recalled. The biggest source of losses for public sector banks was their foreign currency exposure. By recapitalizing the banks and eliminating their existing foreign currency exposure, while simultaneously placing some limits on their future foreign currency exposure, that issue had been resolved. Private sector banks had relatively little foreign currency exposure, and the staff did not have perfect information on the amount of nonperforming loans. A few technical assistance missions had already been conducted with the aim of improving the prudential regulations applied by the Central Bank, but it was the staff's view that the amount of nonperforming loans in some banks was fairly large. In any case, the authorities were committed to requiring shareholders to recapitalize banks that were unable to comply with the relevant banking regulation by September 1991; otherwise, those banks would be either liquidated or merged. As far as public sector banks were concerned, it was difficult to estimate the potential additional budgetary cost as long as the size and nature of the problem, if any, was unclear. Nevertheless, the staff would, in future discussions with the authorities, concentrate on the rather complicated legal procedures for the Central Bank to recover nonperforming loans.

Although the program did not include a performance criterion for the fiscal performance, the staff had considered including one, the Deputy Director commented. In order to include such a performance criterion, however, the reporting must be timely, as it would not be very helpful to have to wait for six months to see whether an element of the budget, especially the overall budget deficit, had been met. The staff had tried to obviate the need for a specific performance criterion for the fiscal performance by including some adjustors in areas where information would become available relatively quickly. If difficulties with the fiscal program emerged, the staff could consider, perhaps at the time of the first review, including some performance criteria to monitor the fiscal performance.

The treatment of foreign direct investment and other capital flows in the balance of payments was a statistical difficulty on which the staff would continue to try to make progress, the Deputy Director remarked. With respect to the behavior of workers' remittances, the staff's projection for 1991/92--$3.4 billion--was close to the figure for 1990/91. On the basis of the first nine months of the year, remittances were in line with the projection, although, in the staff's view, there was a large amount of

capital that was misclassified as remittances, which was another area where more work would need to be done.

There were a number of other areas where more work remained to be done, the Deputy Director of the Middle Eastern Department considered. The budget accounts required reformulation, and there was a clear need for the budget to become an analytical tool and a policy instrument. There would be a need for technical assistance in the areas of income taxation and financial reform, including the structure of interest rates, monetary policy instruments, and capital market developments. In the staff's view, there was also a need for coordination of external assistance; in the past, the staff had not been fully aware of what donors were doing in terms of both financial assistance and technical assistance. The Egyptian authorities had asked the World Bank to establish a consultative group, which was an important element for policy formulation. The first meeting of that group would be held in July 1991.

Mr. Al-Jasser remarked that it was interesting to note other Directors' concerns about the lack of strength of the program, which, in his view, was very strong. Indeed, the program was especially strong given the state of the economy, the negative rates of growth that it had experienced, and the shear size of the economy in relation to the size of the population. There had been a number of comments to the effect that the fiscal effort was not commensurate with the needed adjustment. However, his fear was that there was too much, rather than too little, fiscal adjustment, although he had suggested that the situation did not call for despair; rather, the authorities should ensure the effective implementation of the adjustment and the integration of the various adjustment mechanisms into the fiscal system. Since 1986, the primary budget surplus had been huge, and it was expected to remain in surplus in the coming year. In his view, the dramatic turnaround in the budgetary position over the past few years should not be underestimated as a fiscal measure in its own right.

In other areas, too, the strength of the program was evident, Mr. Al Jasser considered. According to the staff report, "by mid-1993, foreign trade will be almost free of nontariff barriers, virtually all cropping and price controls and input subsidies in agriculture will have been eliminated, and 90 percent of manufactured production will be sold at freely determined market prices." The establishment of a market pricing mechanism was at the heart of the reform effort, and to realize that goal in only two years would be a considerable achievement, especially in light of the somewhat less ambitious goals of some of the programs reviewed by the Board. He was concerned, therefore, about the divergent views on the program, especially its structural aspects. In his view, the program was very strong and the focus should be on ensuring its proper implementation.

The staff representative from the World Bank said that a delegation from Egypt was in Washington to finalize the negotiations on a structural adjustment loan, which was expected to be presented to the World Bank's Board before the end of June. It was the assessment of the World Bank staff, supported by its management, that the reforms in the public

enterprise sector, as well as the direction in terms of privatization, were appropriate at the present stage. In fact, practically all the trade reforms that were included in the proposed adjustment program were to be finalized within three years, as was price liberalization. Consequently, the Bank staff felt that the program was strong, appropriate, and, given the existing constraints on the Egyptian economy, represented very important progress toward achieving the Government's goals.

Mr. Fogelholm considered that it was extremely difficult to compare one adjustment program with another; indeed, the staff continued to struggle with that issue, especially at the time of the reviews of conditionality. In comparing the strength of programs, the Fund tended to concentrate on the members' external balance. In that context, notwithstanding the projected decline in Egypt's current account deficit from about 10 percent of GDP to about 7 percent of GDP, the proposed program could not be considered very strong. A great deal of effort was indeed being directed at correcting the fiscal imbalance, but, considering the size of the imbalance, there was little alternative to the proposed course of action. Like Mr. Végh, he was concerned about the number of actions to be implemented during the next few years. Naturally, one could not predict the extent to which those actions would be implemented, but experience with a number of countries that had submitted similarly impressive lists of intentions suggested that a degree of caution should be exercised, especially in the case of critical countries. In short, one should request more rather than less.

The Chairman said that, although the program had some obvious weaknesses, it was a strong beginning. After three and one half years of negotiations with the Egyptian authorities, the Fund had an opportunity to help the country accelerate and deepen its reform efforts in a framework of financial discipline, a task for which the Fund was uniquely qualified. In view of the urgent need to assist Egypt at the present critical juncture, the favorable policy environment in Egypt, and the readiness of the membership to support the program, it appeared that the potential benefits of supporting the program outweighed the risks involved. He recognized the concerns of Directors, but he was confident that the authorities would implement the program faithfully and in doing so would consider carefully the Board's various recommendations.

Mr. Finaish observed that many speakers had referred to the issue of gradualism and the phasing of the structural reform. In his opening statement, he had tried to show the interlinkages between structural reform and short-term macroeconomic considerations and had indicated that the authorities would probably consider accelerating the implementation of measures in some areas if circumstances permitted. Moreover, it was important to recognize that the program of structural reform was both strong and comprehensive. The decision on the further acceleration of the program involved a delicate judgment about political and social tolerance, and the authorities' views on that matter had to be taken into account. As Mr. Fogelholm had observed, judgments could not be made in isolation by simply comparing one program with another. Circumstances were different in each case, and what might be suitable or necessary in one case might be

neither in another, even though the objectives might be the same. He had the impression that there was, unjustly, a credibility gap in the case of Egypt; whenever the authorities implemented a series of measures, their efforts were described as gradual, and even after taking prior actions, there appeared to be some residual uncertainty about their intentions. There was no doubt that it was wise and advisable to maintain a healthy degree of skepticism in assessing the authorities' actions and intentions, but it was also possible for skepticism to be excessive.

Some Directors had expressed concern about the extent to which enterprises in the private sector enjoyed an equally competitive posture vis-à-vis the public sector, Mr. Finaish recalled. As Directors were aware, a new public investment law had been submitted to the Parliament. Commercial banks were instructed to apply fully commercial principles in their lending to public companies. Government loan guarantees were no longer provided. The holding companies would not simply replace government ministries in terms of control; rather, they would be held accountable for their own financial results through a critical assessment of their return on capital, which would require holding companies to apply strict standards of profitability to the companies under their control, and to proceed to restructure, diversify, or liquidate nonviable enterprises. Moreover, there was a basic change in the macroeconomic environment in which both holding and affiliated companies would henceforth be operating. The application of market-determined interest and exchange rates, for example, meant that some of the distortions in the parameters of the decision-making process had been removed, which, together with the institutional reforms in the legal, accounting, and financial areas, would give assurance that there would not be a return to the former style of managing public sector operations. Furthermore, by the end of 1993, a unified law would be in force, which would apply equally to both public and private enterprises.

In the meantime, Mr. Finaish continued, as had been stated by some speakers, the authorities were also implementing a detailed privatization program. Under that program, 2,000 economic enterprises owned by the Government were being sold to the private sector, and private sector shares in joint companies were being increased. Moreover, holding companies would decide independently on the privatization of, and sale of equity in, wholly owned public sector enterprises. The Government had already decided to sell some of the smaller profitable companies that operated in competitive sectors, and it intended to designate a first group of companies for privatization by December 1991. The Government would like to implement the privatization program as quickly as possible, but implementation would be influenced by a number of considerations that should be taken into account: first, the large number of firms to be privatized and the underdeveloped state of the securities market; second, the need for transparency in the privatization process to avoid the possibility of negative public reaction to the sale of government-owned companies; third, the need to develop effective mechanisms for dealing with the complex issues of labor redundancy and unserviceable liabilities, which were issues in other countries as well; and fourth, the need to ensure broad-based public participation in the privatization process, particularly by small investors.

Many speakers had commented on the viability of the medium-term outlook and the need for international support, Mr. Finaish noted. The quality of that support was very important, not only to improve the debt-servicing profile but also to send the right signals to private investors so as to encourage foreign direct investment from abroad and capital repatriation. By the same token, it was also appropriate for the international community to emphasize to the authorities the need to implement their program with dedication, which, in the long run, would be good for Egypt and, as some speakers had mentioned, the region as well. If the Egyptian authorities' program succeeded, it could set an important precedent for the entire region, particularly in light of the extensive discussions in the Board on the role of the Fund in the Middle East. Consequently, the success of the program was important not only for the Fund as an institution but also for Egypt and the region as a whole. He hoped that Egypt would continue to count on the support of the Fund and the international community.

The Chairman made the following summing up:

On the occasion of the 1991 Article IV consultation with Egypt, Executive Directors also considered and approved the request of the Egyptian authorities for a stand-by arrangement.

Against the background of a long period of negotiations with the Fund and attempts at adjustment that could not prevent the further deterioration in economic activity and the increase in financial imbalances and economic distortions, Directors commended the authorities for the adoption of a comprehensive program of adjustment and economic reform. They considered the program to be deserving of the Fund's support, welcomed the strong prior actions already taken, and considered that full implementation of the authorities' adjustment program held the promise of reducing Egypt's imbalances and forming the basis for sustained noninflationary growth. Most speakers expressed concern, however, at the planned pace of structural reform, and they urged the authorities to act more expeditiously wherever possible.

Directors welcomed the thrust of the reform program, which was to reduce the scope of administrative intervention and increase the role of market mechanisms in the economy. They stressed the critical role of deregulation, investment decontrol, reform of the large public enterprise sector--including privatization--and trade liberalization, starting with a significant effort in sectors where monopolies exist. In their view, a crucial feature of reform policies was an end to reliance on administrative intervention in the exchange and interest rate markets and the establishment of a unified, market-determined exchange rate, accompanied by far-reaching trade reform. This would lay the basis for a strengthening of the current account and an improvement in economic growth. The exchange and trade reforms would require a more flexible system of pricing in the domestic

market and would need the support of restrained financial policies and competitive interest rates. In this connection, Directors emphasized the importance of the Government's actions to decontrol domestic prices, remove subsidies, raise prices of energy products to opportunity cost levels, and introduce remunerative prices for the agricultural sector, particularly for cotton.

Directors cautioned that financial policies will need to be particularly restrained in the early phases of the adjustment program in order to avoid fueling inflationary expectations and prevent the needed price adjustments from feeding into an inflationary process. In this regard, they saw as crucial to the success of the program the reduction in the fiscal deficit to which the authorities are committed and the achievement of the targeted low rates of credit expansion. While the programmed improvement in the fiscal position was regarded as impressive, a few Directors considered that the remaining deficit in 1991/92 and 1992/93 would still be quite high. Directors welcomed the recent liberalization of interest rates and the treasury bill auction process. However, a number of speakers were concerned about the slow progress toward the achievement of positive real interest rates and their maintenance afterwards. They urged the authorities to move more decisively in this area, which they saw as essential for the mobilization and allocation of domestic financial resources and in supporting the exchange rate reform, supported by restrained credit and monetary policies. The authorities were also urged to move expeditiously to implement the full monetary reform and to strengthen bank supervision.

On the specific fiscal measures, Directors welcomed the introduction of the General Sales Tax and urged its further extension, and in general supported the acceleration of work on the income tax reforms scheduled for next year. Directors recommended that possibilities for expenditure reduction be explored further, as a reduction in the deficit by this means would enhance the private sector's role. In this context, the further reduction of widespread subsidies was emphasized.

While Directors accepted the limited use of external grants to replace fiscal measures at the outset of the program, given the particular circumstances, they noted that grants were not durable substitutes for measures. Directors urged the authorities to stand ready to take additional actions to keep the program on track, and they welcomed the indications that the authorities would be willing to consider going beyond their commitments embodied in the letter of intent, provided circumstances allowed.

In that context, most Directors considered the implementation of structural reform to be too gradual. They observed that the gradual pace of reform could put at risk the achievement of the macroeconomic and structural objectives of the program. Moreover,

gradualism would slow the pace of economic recovery, and consumption growth would resume only after some time. While recognizing the risks inherent in a more ambitious approach, they believed that gradualism could result in "adjustment fatigue" before the benefits of reform took hold. They urged the authorities to speed up their reform wherever possible and, in this respect, noted particularly the path of energy price adjustment--given its importance for resource allocation and external and budgetary imbalances--and the need to accelerate reforms of the public enterprises, including, as appropriate, liquidation and privatization of enterprises, disbanding of monopolies, a more liberal investment policy, and a faster pace of trade liberalization. A few Directors, emphasizing the strength and comprehensive scope of the program, considered that the pace of reform was appropriate. They noted that the ultimate success of the program depended critically on strict adherence to the timetable for implementing the agreed reforms.

Directors welcomed the establishment of the Social Fund and expressed the hope that the Egyptian authorities would make steady progress in targeting subsidies to the more vulnerable groups while reducing their overall budgetary impact.

Finally, Directors noted that exceptional external assistance received in 1990/91 had eased the balance of payments constraint in the short term and commended donors and creditors in this regard. They underscored the critical need for debt relief, which would help ensure medium-term viability and provide for renewed confidence, higher investment levels, and a sustainable increase in living standards.

Directors looked forward to a discussion of progress under the program on the occasion of the first review under the stand-by arrangement, which would be a key for consideration whether a basis was developing for a longer-term program, for which some Directors believed the use of ESAF resources should be positively considered.

Directors recommended that the next Article IV consultation with Egypt be held on the standard 12-month cycle.

The Executive Board then took the following decisions:

Decision Concluding Article XIV Consultation

1. The Fund takes this decision relating to the exchange measures of the Arab Republic of Egypt subject to Article VIII, Sections 2(a) and 3, and in concluding the 1991 Article XIV consultation with Egypt, in the light of the 1991 Article IV

consultation with Egypt conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. As described in EBS/91/73, Egypt retains restrictions on payments and transfers for current international transactions evidenced by external payments arrears, advance import deposit requirements, a bilateral payments arrangement, and a multiple currency practice arising from the dual exchange market. These measures are subject to approval under Article VIII, Sections 2 and 3. The Fund welcomes the intention of Egypt to eliminate the external payments arrears and unify the exchange system after a transitional period. The Fund encourages Egypt to eliminate the remaining exchange restrictions as soon as possible. In the meantime, the Fund grants approval for the retention of the restrictions in respect of external arrears and the multiple currency practice until the completion of the first review under the stand-by arrangement for Egypt or February 27, 1992, whichever is earlier.

Decision No. 9728-(91/65), adopted
May 17, 1991

Stand-By Arrangement

1. The Government of the Arab Republic of Egypt has requested a stand-by arrangement in an amount equivalent to SDR 278 million for the period from May 17, 1991 to November 30, 1992.

2. The Fund approves the stand-by arrangement set forth in EBS/91/73, Supplement 4.

Decision No. 9729-(91/65), adopted
May 17, 1991

2. SWEDEN - EXCHANGE SYSTEM

Mr. Fogelholm said that the Swedish authorities had decided to peg the Swedish krona to the European currency unit (ECU), with effect from the close of business on May 17, 1991. Accordingly, Sweden was abandoning the exchange rate system based on linking the krona to a trade-weighted currency basket--a system that had been maintained since 1977--and was instead tying the krona to the currencies of the EC countries. The new exchange rate of the krona against the ECU was such that there was no change in the external value of the krona; it was only the technique for maintaining a fixed exchange rate that had been modified. The benchmark value for the index of the currency basket was replaced

by a central rate for the exchange rate of the krona relative to the ECU, as defined by its composite currencies. The new central rate was 7.40054 kronor per ECU, which corresponded exactly to the benchmark value for the currency index in the previous system. Variations around the central rate of plus or minus 1.5 percent would be permitted, as in the previous currency basket system.

The decision to tie the krona to the EC currencies constituted a unilateral Swedish commitment, Mr. Fogelholm stated. The decision should be seen in the context of Sweden's intention to apply for membership of the European Communities and was the first step in the adjustment of the Swedish exchange rate system to the principles of the European Monetary System (EMS). In announcing the new system, the Sveriges Riksbank had stated that Sweden, as a second step, would seek formal association with the EMS. The ultimate objective was full Swedish participation in the EC system for cooperation in the areas of monetary and exchange rate policies.

The Chairman remarked that the Board would discuss the issues relating to monetary zones in June 1991, at which time Directors would have an opportunity to comment on the important decision by the Swedish authorities.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/91/64 (5/3/91) and EBM/91/65 (5/17/91).

3. ARGENTINA - REPRESENTATIVE RATE FOR ARGENTINE AUSTRAL

The Fund finds, after consultation with the authorities of Argentina, that the representative rate for the austral under Rule O-2(b)(i) against the U.S. dollar is the midpoint between spot buying and selling rates for U.S. dollars ("dolar transferencia") in the free foreign exchange market as quoted by the Banco de la Nacion Argentina and reported by the Central Bank of Argentina. (EBD/91/141, 5/6/91)

Decision No. 9730-(91/65) GS, adopted
May 9, 1991

4. DENMARK - 1991 INTERIM ARTICLE IV CONSULTATION

The Fund notes the staff report for the 1991 interim Article IV consultation with Denmark (SM/91/79) and declares the consultation completed. (SM/91/79, 5/2/91; and Cor. 1, 5/3/91)

Decision No. 9731-(91/65), adopted
May 16, 1991

5. MALDIVES - 1991 ARTICLE IV CONSULTATION - POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, as amended, the Executive Board agrees to extend the period for completing the next Article IV consultation with Maldives to May 22, 1991. (EBD/91/149, Cor. 1, 5/10/91)

Decision No. 9732-(91/65), adopted
May 15, 1991

6. EXECUTIVE BOARD - MOVEMENT OF QUORUM TO BANGKOK

The Executive Board approves the proposed arrangements for the movement of a quorum to Bangkok during the Annual Meetings and for its return to Washington, as set forth in EBAP/91/117 (5/10/91).

Adopted May 15, 1991

7. ALGERIA - TECHNICAL ASSISTANCE

In response to a request from the Algerian authorities for technical assistance in the central banking field, the Executive Board approves the proposal set forth in EBD/91/147 (5/10/91).

Adopted May 15, 1991

8. ARGENTINA - TECHNICAL ASSISTANCE

In response to a request from the Argentine authorities for technical assistance in the central banking field, the Executive Board approves the proposal set forth in EBD/91/135 (4/30/91).

Adopted May 3, 1991

9. CZECH AND SLOVAK FEDERAL REPUBLIC - TECHNICAL ASSISTANCE

In response to a request from the Czechoslovak authorities for technical assistance in the monetary field, the Executive Board approves the proposal set forth in EBD/91/142 (5/6/91).

Adopted May 9, 1991

10. GUYANA - TECHNICAL ASSISTANCE

In response to a request from the Guyanese authorities for technical assistance in the central banking field, the Executive Board approves the proposal set forth in EBD/91/140 (5/3/91).

Adopted May 3, 1991

11. ISLAMIC REPUBLIC OF IRAN - TECHNICAL ASSISTANCE

In response to a request from the Iranian authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/91/138 (5/2/91).

Adopted May 7, 1991

12. ROMANIA - TECHNICAL ASSISTANCE

In response to a request from the Romanian authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/91/143 (5/8/91).

Adopted May 13, 1991

13. THAILAND - TECHNICAL ASSISTANCE

In response to a request from the Thai authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/91/148 (5/10/91).

Adopted May 15, 1991

14. TUNISIA - TECHNICAL ASSISTANCE

In response to a request from the Tunisian authorities for technical assistance in the central banking field, the Executive Board approves the proposal set forth in EBD/91/139 (5/2/91).

Adopted May 8, 1991

15. RELATIONS WITH GATT - CONSULTATIONS WITH CONTRACTING PARTIES - FUND REPRESENTATION

The Executive Board approves Fund representation at the consultations with the CONTRACTING PARTIES to the GATT on Brazil and Czechoslovakia, as set forth in EBD/91/136 (4/30/91).

Adopted May 3, 1991

16. INDONESIA - RELEASE OF INFORMATION

The Executive Board approves transmittal of the background paper on recent economic developments to the Inter-Governmental Group on Indonesia, as set forth in SM/91/88 (5/8/91).

Adopted May 15, 1991

17. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/91/110 (5/3/91), EBAP/91/112 (5/6/91), EBAP/91/115 (5/8/91), EBAP/91/119 (5/13/91), and EBAP/91/120, Correction 2 (5/15/91), by Advisors to Executive Directors as set forth in EBAP/91/110 (5/3/91) and EBAP/91/112 (5/6/91), and by Assistants to Executive Directors as set forth in EBAP/91/105 (4/30/91), EBAP/91/113 (5/7/91), and EBAP/91/116 (5/9/91) is approved.

18. TRAVEL BY MANAGING DIRECTOR

Travel by the Managing Director as set forth in EBAP/91/111 (5/6/91) is approved.

APPROVED: November 27, 1991

LEO VAN HOUTVEN
Secretary